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THE NEW YORK Certified Public Accountant

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THE NEW YORK

Certified Public Accountant

VOL. XXIX *May* • *1959* No. 5

Society and Editorial Offices: 355 Lexington Avenue, New York 17, N. Y.

Accounting News And Trends

Governmental Accounting and Auditing

An example of professional service to state government is shown in a report of a newly formed Committee on Local Governmental Accounting and Auditing Problems of the Arizona Society of CPAs published in that society's BULLETIN (February 1959). Although it is noted in the report that, traditionally, this society had taken little or no official interest in accounting and auditing provided for the governmental units in its state, a decision was made to study the matter and make known the society's opinion as to the most effective plan for use in Arizona.

The study reviewed the governmental accounting and auditing plans provided by state statutes and obtained information from approximately 20 states and the federal government. Data received from other states revealed that there is great diversity in plans used, and quite commonly there is no organized plan. The committee deemed it advisable to first concentrate on the auditing phase of their assignment. Some of their recommendations, applicable to audits on all governmental levels—state, county, cities and towns, school districts and special districts—were:

1. Regular, periodic audits of all governmental units should be required by law. Larger institutions and agencies should be audited annually. Smaller units should be audited regularly, but at specified longer intervals.

2. The law should state that all audits should be made in accordance with generally accepted auditing standards. It should also say that appropriate exceptions should be made in audit reports for any discovered deviations from generally accepted governmental accounting principles.

3. It should be required that the Attorney General or County Attorney, whichever is appropriate, be notified promptly of any discovered defalcation or violation of law in order that proper action may be taken.

4. Officially appointed auditors, whether independent accountants or government employees, should have the right to receive legal opinions from the Attorney General or County Attorney in matters pertaining to their assignments. They should also have the right to request these legal officers to use their subpoena powers if necessary.

Since this is a report from a special committee to the executive committee of the state society it makes no specific suggestions for putting its recommendations into effect. The publication of this report, however, might well lead to the establishing of closer liaison with government officials.

Competitive Bidding

The members of the California Society of CPAs recently responded to a mail ballot on the abolition of competitive bidding. That society's CPA NEWSLETTER (March 1959) reports that as a result of the balloting the by-laws have been amended to read "A member shall not make a competitive bid for a professional engagement." A tabulation of the votes showed 1,886 in favor of the by-law and 869 opposed.

ACCOUNTING NEWS AND TRENDS *is conducted by* CHARLES L. SAVAGE, CPA. *He is presently serving as a member of our Society's Committee on Legislation.*

Dr. Savage is professor of accounting and chairman of the Business Administration Division of St. Francis College.

Staff Compensation

"Staff Compensation Survey" (March 1959), a research bulletin published by the Practice Management Committee of the Colorado Society of CPAs, is based upon responses from 75 percent of the firms to whom the 32-item questionnaire was sent. Since those answering included all the principal firms, the committee is confident that the findings are generally representative of the profession in Colorado. Some of the items revealed by the survey are:

1. *Pay Period.* Two-thirds of the firms paid accounting and non-accounting personnel on a semi-monthly basis. Fewer than ten percent compensated employees on a weekly basis.

2. *Average Compensation.* Firms were divided into four groups depending on size and location. For the firms with over 10 in personnel the average annual compensation was: Juniors—\$4,500; Semi-seniors—\$5,400; Seniors—\$6,900; Managers and Supervisors—\$10,800.

3. *Profit-Sharing Plans.* Approximately one-third of the firms had some kind of profit-sharing arrangement. Denver firms with 4 to 10 in personnel made the most use of this plan. Of firms using profit-sharing nearly 40 percent included semi-seniors and juniors.

4. *Overtime Pay.* In all sizes of firms, juniors and semi-seniors usually received time and one-half for overtime, while seniors and supervisors received straight time. In most Denver firms with 4 to 10 in personnel, however, no overtime was paid to seniors and supervisors.

Education and the CPA Examinations

An item on the educational and experience background of candidates taking the May 1957 CPA examination in California appeared in that society's CPA NEWSLETTER (March 1959). An

analysis of the preparation of the candidates showed that almost 37 percent were college graduates with an accounting major, and of these slightly over 50 percent either passed or obtained a condition. College graduates without an accounting major did not make as good a showing and 93 percent of the candidates with only a high school education failed entirely.

Type and length of experience did not show a strong correlation with success in the examination, although candidates with a combination of teaching and CPA experience made a somewhat better showing. The results of this study support the obvious thesis that education is the key to success in the CPA examination.

School District Accounting

Cooperation between State Government officials and the accounting profession in the field of accounting for school districts is described in THE MICHIGAN CPA (January 1959). The Superintendent of Public Instruction has recently appointed a committee to revise the school accounting manual and has included members of the Michigan Association of CPAs on this committee along with representatives of various Michigan school districts. At the same time the Association's Committee on Accounting and Auditing Procedures met with officials of the Department of Public Instruction to consider revision of the school audit program to follow the new accounting manual.

A Statement of Accounting Principles for Health and Welfare Funds

A committee of the California Society of CPAs has published a "Statement of Accounting Principles For Health and Welfare Funds" in THE CALIFORNIA CPA (March 1959) which contains a number of specific suggestions that accountants should find helpful. This is not an official statement of

the California State Society and the headnote warns that because experience in this field is somewhat limited and additional federal and state legislation regulating the financial reporting on activities of these funds may well be anticipated, the concepts expressed in the statement may have to be changed.

The accounts for health and welfare funds should be placed on the accrual basis for statement purposes. In order to be able to prepare financial statements promptly the Committee recommends that the fiscal year should end one month after the closing of a qualifying period. The employers' contributions to be taken into account in that fiscal year would be for the 12 months ending when the qualifying period ends, which is one month earlier than the fiscal year-end. The liability for insurance premiums payable for benefits earned should be recorded at the fiscal year-end to the extent that employees have qualified for such benefits. Under this suggested method of accounting, the employers' contributions relating to the last month of the fiscal year (which is the first month of a new qualifying period) and the related liability for insurance premiums are not taken into account until the subsequent fiscal year. These exclusions should not prevent the issuance of an opinion on the financial statements by a CPA.

It might be pointed out in passing, however, that quite a few of these funds are maintained on a cash basis. This practice has been upheld in some of the literature in the field. For example, Mr. Percy A. Lockitch (Journal of Accountancy, January 1958) suggests that the cash basis, with the audit report properly qualified to disclose assets and liabilities not determinable as of the date of the audit, will best serve the administrators of the trust. Mr. Raymond Buchbinder suggests a similar view in the February 1958 issue of The New York Certified Public Accountant and also presents an opinion

that might be submitted in such a situation.

As an Appendix to the "Statement" the committee presents a standard opinion which it believes is applicable in this case, a suggested statement of assets and liabilities, and a suggested statement of operations. Any accountant interested in this field of accounting would be well advised to obtain a copy of the complete statement from the California Society of CPAs, 530 W. Sixth St., Los Angeles 14.

The Use of Electronic Data Processing Equipment—a Report

In order to obtain specific information on the success or lack of success of installed electronic data processing equipment, the Systems and Procedures Association conducted a survey of its members. The results are reported in a booklet "Computer Use Report" (price $1.50; Penobscot Building, Detroit). The questionnaire covered three areas:

1. Acceptances for service by applications and requested information such as estimated savings, reasons for accepting, opinion of results and computers involved.
2. Rejections on an application basis and reasons for rejections with indication of the stage at which they were rejected.
3. Specific information about the replying firms. This information was summarized in seven tables: (a) Applications accepted for electronic computer operation; (b) Applications rejected for electronic computer operation; (c) Application occurrence by size of firm; (d) Industry occurrence of applications being programmed and in service; (e) Industry occurrence of applications rejected; (f) Size of 87 firms conducting preliminary studies; (g) Payroll in service — savings by industry and by number of employees.

This booklet may be of real help to those companies who are considering the installation of such equipment.

Letters to the Editor

The Export-Import Bank

Recently there has been considerable interest on the part of accountants in the Export-Import Bank of Washington (Eximbank) and its operations. This increased interest probably stems from a new policy adopted by Eximbank under which it has made definite efforts to encourage smaller loans by standardizing and liberalizing its application procedures for exporter credits and by further publicizing its availability.

Eximbank believes that short-term credit is available to exporters through commercial banks and so limits itself to medium and long-term credits. Generally, this means a minimum of one year. In exporter credits, the foreign importer is required to pay at least 20 per cent cash and the American exporter must extend credit of at least another 20 per cent. There is no reason why the exporter could not obtain his 20 per cent participation from a commercial bank or any other customary source of credit. Eximbank can then supply the remaining credit needed up to 60 per cent. Eximbank, when it can, prefers to participate on some kind of partnership basis with commercial banks. Should a default arise, the exporter's credit and Eximbank's credit must bear proportionate shares of the default.

Even where financing will not be made under a partnership arrangement with a commercial bank, it is strongly suggested that the aid of a bank be sought in filing an application as such applications tend to be more complete. It is best to make preliminary inquiry by letter, phone, or in person, giving only the country, the product, and the name of the proposed buyer before filing a detailed application. On the basis of this information, the bank can tell you whether the transaction is generally eligible for consideration.

The credit information concerning the foreign importer required by the bank consists of financial statements, a credit report from the importer's own bank, and a statement from the exporter of his experience with the importer. Balance sheets and profit and loss statements for the last 3 to 5 years are needed, preferably audited but otherwise signed by the purchaser, translated into English and converted into dollars at a stated rate of exchange. If the total credit (including that extended by the exporter) does not exceed $50,000 or if payment is to be guaranteed by a foreign financial institution, statements are required for one year only. In either case, if the latest balance sheet submitted is more than one year old, an informal but current trial balance should also be furnished.

The credit report from the importer's bank must state how long the purchaser has been in business, how long the bank has known him, and for how many years and in what amounts the bank has extended credit to him. The foreign bank is also asked to give their opinion of the purchaser's reputation in the general community and in meeting financial obligations, and finally whether his business has improved or declined in recent years.

The statement from the exporter concerning his business experience with the importer should state the number of years of experience, sales volume with

him for the past 3 years, the purchaser's payment record, and the terms and the average amount of credit extended per year. The last question to be answered calls for the exporter's appraisal of the purchaser's credit standing.

Considering the public ownership of the Export-Import Bank, criticism does not seem to be unusually virulent. Complaints generally fall into four groups—red tape, stinginess, the large transaction complex, and information facilities. To meet three of these complaints the Bank has made a real try at lending encouragement to smaller loans by disseminating publicity and information, and by adopting an application form for the optional use of prospective exporters.

The Export-Import Bank is proud of its low loss record over the last quarter century of five one-hundredths of one per cent. However there are people who believe that this rate is low because, as

in baseball, only errors of commission are counted, not errors of omission. They argue that the bank was formed to serve American exporters, not to make a profit, and that by liberalizing its credit, it could render a great deal more service. Unfortunately, small loans are still only a minor phase of the Bank's work.

Perhaps what is needed is a separate branch to deal with smaller export loans located at the hub of exporting here in New York City where exporters could obtain information more easily.

LOCKE GRAYSON, CPA
(Gruhn & Grayson)
New York, N. Y.

Tax Court of Domestic Relations

If you look through the case books on taxes, you will find quite a number that have to do with what is called "domestic difficulties", usually but not always, between husband and wife. Such troubles are, more often than not, incident to divorce. Many people are deterred from fighting the tax assessment, because they do not want a public record made of the troubles. Naturally, some of the best cases never reach court. I want to tell the readers of THE NEW YORK CERTIFIED PUBLIC ACCOUNTANT about a few in which I have had some part. All names are, of course, fictitious.

In the first one I was merely an unwilling listener. I was working on a set of books in the outer room of a lawyer's office, and the squabble came over the transom, in such tones that I could not help but overhear, and it delayed my work considerably.

It seems that John and Anna had each had a business of their own before they got married in the middle of the year. At the end of the year John pointed out to Anna that a joint return was a big money saver. Anna balked.

John had solemnly promised that whatever she made was hers; and that he would not even ask about it. John, with difficulty, persuaded her to let the lawyer make the joint return. Each would make a separate schedule C. and he would combine them, and only he would know the details. This he had done. The squabble was "who gets the saving?" The obvious and logical way—to divide the saving in proportion to the respective incomes—was out. That way, John would know how much Anna had made. The lawyer advanced various splits, such as 60-40. Anna would have none of it. She wanted the entire saving. And by gosh, she won. For a while it sounded as though next year they would be making separate returns, by reason of divorce.

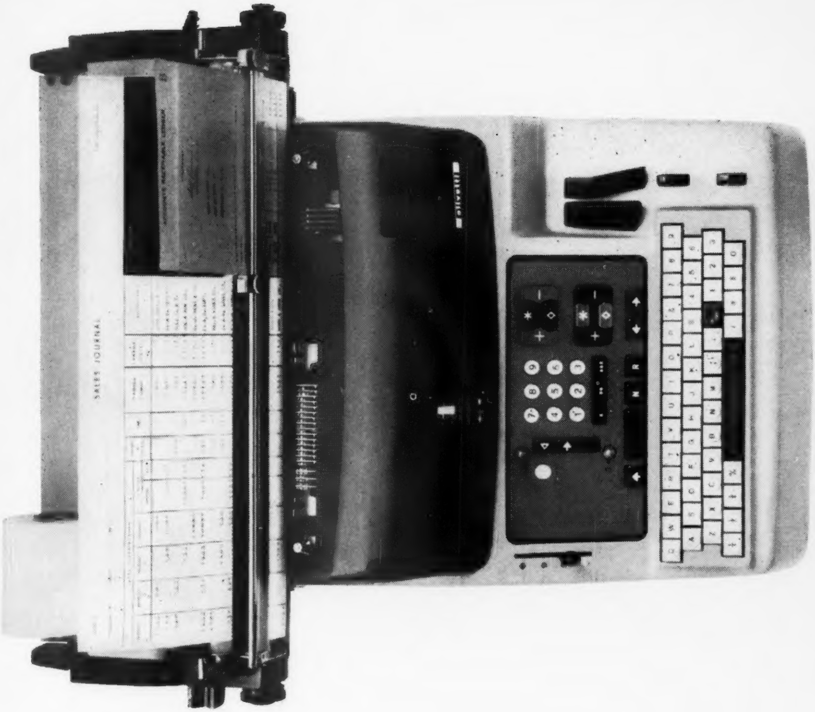
In another case I was literally in the middle. Gus and Maybelle had been divorced early in the year, but were still married, of course, during the preceding calendar year. They knew from seven years of marriage that a joint return was economical. So, they turned up in my office a couple of days before the April 15th deadline to have the return made. Gus sat at my left; Maybelle at my right. And at first all was smooth as I jotted down the data. But when it came to the dependency credit, for the one daughter, trouble started. For the year in question, there was nothing to it. But Maybelle declared then and there that for the current year, she was going to have it, since she had custody of the daughter. Gus insisted that since he was paying support for the child and scrupulously obeying the court's order, he was entitled to the credit. And if I had not been between them, they would have come to blows. It took me a half hour to get them quieted enough so that I could complete the return.

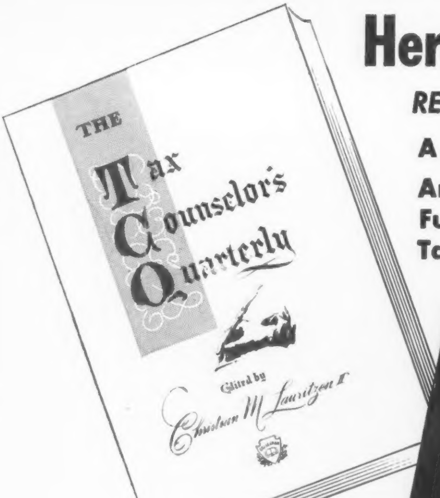
Another case that did not go to court, concerned Walter and Carry. As far as Walter knew, Carry had no income of her own, since she quit her job after marriage. What he did not know was that she had inherited a nice block of stock from an uncle, and that the stock had begun to pay very nice dividends. She never mentioned it. So, when Walter made up his return each year, he made it correctly, to the best of his knowledge. Then one day a revenue agent came to him and accused him of falsifying his return by omitting the dividends. Then, and only then, did Walter find out about Carry's stock.

Carry at first was indignant. She used most unladylike language to describe the treasury agents who had learned about the dividends, and informed about them to her husband. The prospect of his being heavily fined for the omission did not seem to concern her, until their lawyer told her that she too was liable for negligence, at the very least, since she had co-signed the joint returns. He backed up Walter in suggesting that she pay the additional tax and interest out of her concealed income. With purely feminine logic, she declared she would do no such thing. Their ranch-type house was in their joint names, but Walter paid all the taxes on it. And even if the stock was hers alone, nevertheless it was a husband's duty to pay all taxes. And what's more, that's just what poor Walter had to do.

Not all fights, however, are between husband and wife. A New York CPA can tell you of a tax return he once made for a woman, whose brother was a prominent CPA. "Why," he inquired, "don't you let your brother do this? He won't charge you, but I must." Then he found out that she was one of those extrovertive persons who cannot tolerate details, and had bitterly resented the perfectly proper questions which her brother had asked. And a hot quarrel had ensued. The other CPA, being no kin, she managed to restrain her tongue and temper as he asked the same questions. "But believe me," this man concludes, "I earned my fee."

LEWIS GLUICK, CPA
Miami, Florida





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HELP WANTED

Lecturer for CPA examinations preparatory course located in New York City, must have ability to keep the interest and attention of class, teaching experience required, write stating qualifications, experience, etc. to Box 1709.

Accountant, for southeastern Florida CPA firm, college degree, public experience required, some hotel experience desired but not necessary, send resume including salary desired. Box 1726.

SITUATIONS WANTED

Immediately Available, accountants, office managers, bookkeepers. Bookkeepers & Accountants Division, Maxwell Employment Agency, 130 West 42nd Street, N. Y. C., telephone LOngacre 4-1740.

Financial Executive, CPA, law degree, over 25 years extensive experience, public, private, recently assistant comptroller national manufacturing company, seeks more challenging opportunity, $10,000, presently public accounting free lance. Box 1710.

CPA, age 45, 25 years public accounting with emphasis on institutions, non-profit, fund raising, hospitals, investments, real estate, seeking per diem or part-time employment. Box 1712.

Accountant, assistant controller, CPA, 38, seeks responsible position in upstate N. Y., 11 years diversified, public 2 years, broad industrial experience. Box 1721.

Accountant/Bookkeeper, female, diversified experience including public accounting, wishes part-time position, available up to four days weekly, can vary days according to your work load. Box 1727.

CPA, 32, nine years large and small firm tax and audit background, available for per diem in N. Y. C. and N. J., weekends or evenings only. Box 1728.

Bookkeeper, FC complete GL work including trial balance and payroll taxes, 10 years experience, available Saturdays and one evening. Box 1731.

BUSINESS OPPORTUNITIES

Mail and Telephone Service, desk provided for interviewing, $6.50 per month, directory listing. Modern Business Service, 505 Fifth Avenue (42nd Street).

Practice Wanted, substantial terms, know-how offered overburdened or retiring practitioner, CPA, N. Y., N. J., AICPA, IE, MBA. Box 1713.

Well Equipped CPA Firm, will purchase all or part of the practice of overburdened or retiring accountants, substantial cash or attractive retirement arrangements will be offered. Box 1714.

CPA, desires to purchase practice, New York City area, honor graduate, excellent tax and accounting background, specializes in highest type professional service to small and medium size accounts, excellent financial terms, replies held strictly confidential. Box 1715.

CPA-Attorney, mature, with small quality practice seeks CPA with $10,000 or better practice as partner, prefer out of N. Y. City practice. Box 1716.

CPA, desires to purchase all or part of practice or partnership interest of overburdened or retired practitioner, Metropolitan area, excellent financial terms. Box 1717.

Certified Public Accountants, midtown, well established, seek CPA of partnership stature, with quality practice of $25,000 plus, who wishes to associate with medium size, progressive firm. Box 1718.

Mr. Small Practitioner, if you are slowing down, have nobody to leave the practice to, and wish to establish a relationship with a 35 year old CPA who has plenty of steam left, I have the capital and know-how to effect a semi-retirement buy out program which will get you out of the office and on the way to Florida where you really ought to be, meet me for lunch, on me of course, and let's talk it over. Box 1719.

CPA, AICPA, NYSSCPA, seeks associate with modest practice, who has time for per diem work, partnership status possible. Box 1720.

CPA, mature sole practitioner, medium practice, desires to contact an accountant interested in exploring the possibility of merger or association for mutual coverage, prestige, continuity upon retirement, replies held strictly confidential. Box 1722.

BUSINESS OPPORTUNITIES

Office for Rent, Broadway, City Hall vicinity, private office in CPA's suite, furnished or unfurnished. Box 1723.

Wanted, share office space, midtown area, state rental and facilities offered. Box 1724.

Share Room in CPA suite, excellent midtown Fifth Avenue tower floor, secretarial service available. MU 7-1080.

CPA, 20 years public accounting and tax experience, modest practice, desires association with firm that can use superior services. Box 1725.

Desk Space Available, at 450 Seventh Avenue, corner of 34th Street, in air-conditioned offices with pleasant surroundings. Call WI 7-3015, Mr. Grant.

Office Space Available, dignified, carpeted, bright furnished room or desk space in midtown CPA office. LA 4-4444.

Seventh Avenue Pent House Office for Rent, excellent light, attractive rental of $125 monthly, ideal for accountant, garment area. Bayer, WIsconsin 7-8196.

CPA, NYSSCPA, desires to purchase small practice or individual accounts in the metropolitan area, N. Y. C., Nassau, Suffolk, excellent financial terms. Box 1729.

CPA, with a substantial gross, N. Y. City and out of town clients, fully equipped and attractive mid-town office, seeks association with smaller practitioner with quality practice, opportunity for partnership arrangement. Box 1730.

CPA-Attorney, wishes to share his newly decorated air-conditioned four room suite, with or without services. WOrth 2-3398.

The President's Page

Since this is the last time I shall have the privilege of addressing you through this department it would seem appropriate to review briefly the progress of our Society during the past year and to record my personal views as to future needs and programs.

Progress of an organization such as ours cannot be measured adequately in short-term cycles. Each administration continues to implement policies initiated by previous administrations and to develop its own long-range plans. It also carries on the normal, technical, administrative and public relations programs built up over a period of years.

Space does not permit an elaboration of the results of all policy decisions of prior years which have contributed to our present position of influence. Nor does it permit mention of the past officers, directors, chairmen of committees and members who have contributed so greatly to these advances. The following, however, are illustrative of the programs which have been under study and consideration for considerable periods of time and which were brought to fruition during the past year.

1. The enactment into law of our Society-sponsored regulatory bill first attempted in 1924. It has long been the opinion of our Society, recently confirmed by the American Institute as well as other interested individuals and groups, that the public interest required the application of appropriate disciplinary rules and regulations to all who practice as independent public accountants and, further, that the practice of public accounting be ultimately limited to Certified Public Accountants.

2. Conclusion of a joint statement by the New York State Bar Association and our Society relating to areas of practice and the establishment of appropriate machinery for the amicable settlement of possible misunderstandings.

3. Relocation of the Society office to provide, over a long period of years, not only for more efficient operations but also for future growth and development.

4. Completion and distribution of a Committee Chairman Manual.

5. Completion and distribution of a Chapter Manual.

6. Adoption of a retirement program for the staff.

7. Establishment of new membership award to chapters.

Numerous forward steps were authorized to strengthen our organization, to encourage more active participation in Society affairs and to advance professional development. The promotion or implementation of

these programs will occur largely in future years and will affect the following areas:

1. Establishment of a separate organization for accountants in training under the sponsorship of the Society.

2. Formulation of policies covering awards to Certified Public Accountant candidates for outstanding scores on the examination.

3. Study and installation of an improved insurance program for members.

4. Planning for continuing, or new, programs for professional development. The Society has sponsored established courses in report writing and accountants' liability and has authorized the preparation of courses in the fields of management services and tax practice. In order to coordinate future programs, consideration must soon be given to additional staff assistance.

Foremost among our obligations, particularly when the regulatory law becomes effective, will be the development and maintenance of friendly and cooperative relationships with enrolled public accountants and their organizations for the purpose of improving educational, technical and ethical standards and to provide aid in fulfilling the requirements for the CPA certificate.

An essential characteristic of a profession is its ability to provide self-regulation. Public accountants will soon be under the same discipline now applicable to Certified Public Accountants. Members of our Society are governed by a stricter discipline under our own self-imposed code of professional conduct. It will be incumbent upon us to encourage enrolled public accountants to adopt similar procedures for self-discipline. To this end, serious consideration must be given to the restatement of our own rules of professional ethics by our Committee on Professional Conduct and to the employment of a staff member responsible for the necessary staff work in this area.

The foundation of our Society and our profession is now well established. Its future growth and dedication to the public interest are assured. It has been a personal privilege to have served as your President during an active period of achievement. A corollary privilege has been the opportunity to observe the devotion to the profession of the members of the board of directors, the committees and the staff. To them and to all of the members I express my gratitude and appreciation for their guidance and support.

HOWARD A. WITHEY,
President

Recurring Problems Confronting the CPA and the Credit Grantor

By Saul C. Hertz, CPA

Underlying the relationship between certified public accountants and credit grantors is the seeming conflict between the primary responsibility of the accountant to his client, and the ethical and legal responsibility of the accountant to third parties. The author recommends a revised approach to certain aspects of professional practice including an extension of minimum standards of professional accounting services and a broadening of responsibilities in the case of small or medium-sized clients who may seek large amounts of credit.

Accounting conventions have evolved over a period of more than half a century. Yet it has been only a score of years since the codification of accepted accounting principles and auditing standards and procedures was begun in the pronouncements of the auditing and accounting procedure committees of the American Institute of Certified Public Accountants. The steady growth of standards of practice for the profession since the late '30s is directly attributable partly to the maturity of the profession but even more to its sensitivity to public demand.

In the area of large, listed corporations, the public, to whose needs the profession responds, consists of the stockholders. Their interests are represented largely by investment bankers, the stock exchanges, and various governmental regulatory agencies such as the Securities and Exchange Commission, the Public Utilities Commission, and the Interstate Commerce Commission. Among closely-held small and medium-sized businesses, the practice of accounting similarly has expanded to a great extent in response to the demands and requirements of commercial bankers and mercantile credit grantors. Like their colleagues in the investment banking business, these two groups have come to understand both the breadth and the necessary limitations of the profession. Their reliance upon

Saul C. Hertz, CPA, *is a member of the Board of Directors of the New York State Society of Certified Public Accountants. He has served on numerous committees of the Society and as chairman of the following committees: Cooperation with Commercial Credit Grantors; Insolvency and Bankruptcy Procedures; and Textile Accounting.*

Mr. Hertz is senior partner in the firm of Hertz & Herson, Certified Public Accountants.

the profession for sound guidance of their customers as well as adequate credit information gradually has increased. It is now, therefore, essential that appropriate literature be developed dealing specifically with recurring issues confronting the CPA and credit grantor. Such literature should provide guides for acceptable practice in this area.

The general approach toward the role of the profession described in this article originated largely in the textile and textile-products industries. Over the years, in these industries, small business has predominated and large amounts of credit in proportion to capital have been granted. But the principles herein considered are similarly applicable to most small and medium-sized firms seeking credit. Some of the recommended practices, duties, and responsibilities will appear radical and perhaps beyond the scope of the profession's official position. This article, however, will endeavor to reconcile such apparent deviations with generally accepted practices and procedures.

For purposes of discussion, a small or medium-sized company will be defined as one with a Dun & Bradstreet rating of less than AaA1 (capital in excess of $1,000,000 and "high" credit standing). It normally will not have a complete internal accounting, controllership, or financial management staff, and the CPA usually fills the gap. Thus, a significant part of the problem relates to the question of the extent of participation by the certified public accountant in a client's internal affairs and the degree of responsibility imputed to him as a result of his management advisory functions.

In general, it may be said that commercial credit grantors and bankers expect the broadest type of accounting services for their customers including (depending upon the independent financial strength of the client) verified annual audits, monthly or other interim reports, and financial management advice and control. Each of the major categories of functions is discussed in this article.

Annual Reports

In order to fulfill the broadened role described, it is essential that the accountant prepare for each client, at least annually, a verified long-form report. For the type of companies considered here, in contrast to large, listed corporations, this report usually is prepared in original form by the CPA directly from the client's books and records. It serves, therefore, as the original financial statement to management as well as the basis for published financial information to be used in obtaining credit. To fulfill its dual purpose, the report should be rendered with an unqualified opinion, if possible. Unless a detailed report is prepared internally by a competent accountant, it should be in long form, and should contain detailed comments regarding the audit, the accounts, and the transactions during the period, with appropriate statistical and analytical data. If an adequate detailed report is prepared by an internal accounting staff, the CPA should review the general data for competence of preparation as well as the particular statements on which his opinion is to be rendered; in such case, a properly footnoted short-form report may be adequate.

In unavoidable circumstances, where it is necessary to render a qualified opinion or to disclaim an opinion with respect to the statements as a whole, every effort should be made to fulfill at least the auditing standards required for full verification. An annual report that

carries a disclaimer because of inadequate audit scope has limited utility from the point of view of both the accountant and the credit grantor. The data cannot be used with a proper degree of confidence by either the former in providing his client with financial guidance or the latter in making a valid credit decision. Nevertheless, whatever the qualifications or disclaimer, the report must be rendered with the same degree of alertness as to the conformity of the statements with generally accepted accounting principles complete with informative disclosure of material facts as if it were entirely unqualified.

The designation of reports as "unaudited" or "unverified" has been justified in situations where the accountant suspected or even knew of the existence of errors, misleading information, or misrepresentations in the statements. This kind of rationalization is spurious, and the accountant must not assume that he relieves himself of responsibility when he allows his name to be associated with false or misleading financial statements no matter how he seeks to disclaim responsibility for the contents.

In the area of practice to which this article is directed, agreement by the client to the preparation of an annual "certified report" is being prescribed more and more by accountants as a minimum prerequisite for acceptance of an engagement. Practitioners who have adopted this policy reason that, while the public is expected to read letters of transmittal and differentiate between opinions and disclaimers, the promulgation of false financial statements on accountants' letterheads, albeit with disclaimers and with no knowledge of the falsity, nevertheless subjects them to criticism by credit grantors and others who have relied upon their reports. With the growth in stature of the profession, the argument that accountants must not overstep their positions by attempting to prescribe such procedures or generally impose their views upon clients appears to be receding.

Credit Agency Reports

Closely held companies rarely have occasion to publish financial data for general circulation. In most cases, the only "published" information about such companies is contained in credit agency reports. These reports provide both financial statements submitted by the companies and the results of periodic independent investigations by the agencies themselves regarding the histories, management, credit positions, and payment records of the companies. In addition to facts and figures, some credit agencies also supply opinions, ratings, recommended credit lines, and even actual credit checking service for clients.

The form and extent of information submitted to credit agencies varies with the client depending upon his taste and his financial strength and independence. If the CPA is advising a client, he should recommend the submission of a maximum amount of information consistent with the best interests of the client. This would include a balance sheet with appropriate footnotes and a condensed statement of operations. If the agency's form is inadequate or not suitable, a copy of the report prepared by the CPA may be submitted. If the latter contains confidential information which the company does not wish to publish, portions of the report may be marked "confidential" and will not be published by the agency. While a short-form report generally is inadequate for internal use, it is fully acceptable for submission to credit agencies provided the accounts are properly footnoted and appropriate explanations are included.

The submission of reports to credit

agencies by clients is entirely voluntary but generally is expedient from the point of view of the client since most resources extending credit require the information. Publication of financial reports through credit agencies saves the time and expense of both management and the accountant. It obviates the necessity of answering credit inquiries in connection with routine purchase orders and enables the credit grantor to approve orders quickly by making the credit information readily available. If financial information is not published, many resources will require submission by the client of the CPA's original report or completion of the resource's own financial statement form.

Provided he need not express an opinion, the independent CPA usually may remain neutral with respect to the nature of financial statements submitted to credit agencies. However, a material omission or the preparation of the form in a manner which may mislead the reader is not to be condoned by the accountant even though his signature does not appear. On the other hand, the failure to submit any financial information to the credit agencies by a company is usually interpreted by credit grantors as an act of weakness, an effort to withhold adverse facts. It, therefore, need not be considered misleading. On the contrary, it often serves notice upon them to seek current information by direct inquiry before approving orders.

Where credit agency reports contain space for accountants' signatures and opinions, the principles of the American Institute of Certified Public Accountants' Statement on Auditing Procedure No. 28 relating to this point, should apply. In general, the CPA should not sign a form containing an incomplete financial statement such as a balance sheet without the related operating data, or a condensed financial statement without proper footnotes or adequate disclosure of material facts or post-balance-sheet events.

Post-Balance-Sheet Events

Statement on Auditing Procedure No. 25 deals with the auditing and reporting of events subsequent to the statement date and prior to the submission of the report. No such authoritative consideration, however, has been given to significant events that have occurred or are discovered after the report has been released. Events of this type, which may significantly and adversely affect the solvency or liquidity of a company, include: (1) strikes or casualty losses, (2) deliberate or controllable actions by directors or stockholders, such as the retirement of capital stock, reduction in capitalization, a declaration of dividends, or the payment of bonuses or other unusual compensation, and (3) the hypothecation of an asset after the closing date. Such events may be contrasted with chronic or inherent defects in a business and their manifestations, such as downward trends in operations, which appear continually in periodic financial statements.

A post-balance-sheet event which materially affects the solvency or liquidity of a company, and accordingly its ability to meet its maturing liabilities, should be disclosed voluntarily at least to major creditors. If not so disclosed, it inevitably will be revealed either through indiscretion, regular routine credit inquiries, or in the next issued report, unless its effects are reversed or offset by some independent subsidy. When it comes to the attention of important creditors through an involuntary channel, such as by rumor, not only may the flow of credit be af-

fected, but the failure to reveal it immediately will jeopardize the reputations of both the client and the accountant. Thus, voluntary disclosure at the initiative of the client is almost universally expedient from his own point of view.

The result of voluntary disclosure may be the cessation of credit lines. It is nevertheless better, from both a moral and a practical point of view, to have creditors, who share the risk, share the responsibility for remedial action than for the client to take the matter into his own hands. As a matter of experience, the normal problems of running a small business profitably are numerous and challenging, per se. It is highly inexpedient to add those that would of necessity accompany a suddenly weakened financial condition while simultaneously trying to withhold the information about the weakness. In cases of either temporary financial embarrassment or complete insolvency, it is always easier to make favorable or equitable arrangements with creditors if the facts have been disclosed quickly. The creditors of a debtor who has appealed to them in a forthright manner have greater confidence in his honesty and integrity. They, therefore, may be expected to be more amenable to arrangements that legally protect new creditors and, thus, enable the company to operate while the basic problem is being studied, measured and resolved.

Where a significant post-balance-sheet event has occurred, it is important for the CPA to understand its effect upon the credit position of the client. Generally, its ultimate importance will be measured by the extent of impairment or appropriation of working capital caused by it and the adequacy of working capital thereafter. In some instances, such as in the case of a fully insured casualty loss, the basic financial strength of the company may not be affected at all, even though a significant amount of working capital is temporarily frozen pending negotiation of settlement with an insurance company. In such circumstances, it may be desirable to inform large creditors immediately and request a temporary moratorium on major maturities, rather than permitting liabilities to become overdue and risk legal action on the part of creditors.

The responsibility that falls upon the CPA in the case of post-balance-sheet events of the type and scope described, though perhaps difficult to accept, is important. If he is known to be performing monthly audits, he will be presumed by at least some credit grantors to have a continuing association with the last issued report with which he was identified. And, depending upon the independent financial strength of the company and the amount of credit involved, new creditors often will base their decisions on that report (unless the amounts of credit are very large), at least until the next annual or semi-annual report is due. Of course, the CPA cannot divulge confidential information about his client without the latter's permission. But, by saying nothing, doesn't the CPA tacitly endorse the continuing validity of the last issued report? This is a most difficult dilemma and one that persistently recurs because larger creditors continually seek current interim financial information.

Thus, the failure to disclose significant post-balance-sheet events traps both the CPA and the client. The independent position of the CPA becomes untenable, influenced by the vulnerable position in which he has placed himself by not disclosing facts that ultimately must be revealed in a fairly prepared, regularly issued report. And the client becomes more greatly attached to his secret as

time passes. In the circumstances, the wisdom of the CPA must prevail from all points of view if he presents the problem and its solution in a clear-cut manner—voluntary disclosure—to a client who is honest and soundly motivated.

Interim Reports

In companies that are too small to absorb the costs of highly skilled, internal accounting staffs, the preparation of monthly and other interim financial statements generally is the responsibility of the independent CPA. The smaller the margin of equity on which a company is trading in relation to total debt, the more sensitive is its financial status to seasonal and market fluctuations, style changes, and other short-term factors. The interim (preferably monthly) report, therefore, is essential to the intelligent conduct of the business. It is also an important factor in the obtaining of credit. With it, management and credit grantor alike are able to study the effects on a company of market phenomena and anticipate financial problems. Similarly, the vigilant accountant depends upon the interim report to spot weaknesses or trends before they become deep-rooted problems, and thus guide his client on the most expedient course.

Interim reports generally are rendered with a disclaimer of opinion by the CPA in accordance with AICPA's Statement on Auditing Procedure No. 23. Nevertheless, because of the heavy reliance upon them by both credit grantor and management, interim reports must be prepared in accordance with accepted accounting and reporting principles and standards. The CPA must be fully conversant with items and transactions reported. Interim audit procedures should be adequate to assure both correct bookkeeping techniques and the application of sound accounting principles. Unusual, significant, or unclear transactions or accounts should be analyzed. Inventories should be carefully reviewed as to accounting method, arithmetical accuracy, and consistency with cost records and the books of account. Appropriate adjustments for corrections of book entries, accruals and valuation reserves should be made. Where a physical or estimated inventory (rather than a break-even inventory) is used, provision should be made for estimated federal and other taxes, based on earnings, or the recovery thereof if there is a loss and a resultant carryback claim. The report should contain adequate disclosure of all known facts significant to the financial position of the company including designation of hypothecated assets and secured liabilities, a description of the source of the inventory figure used (e.g., "estimated," "submitted," or "required to break even"), and descriptions of unusual assets and liabilities. It also should, of course, if required by the circumstances, contain a general disclaimer of opinion by the CPA.

Credit men and even some accountants often refer to interim reports as "trial balances." This loose parlance is highly misleading and confusing, and should be discouraged. The type of company with which credit men deal rarely records in its books of account, on an interim basis, adjustments for accruals, inventories and valuation reserves. And an accounting report certainly should never be transcribed directly from an unadjusted general ledger trial balance.

Essentially, there are two kinds of unverified, interim financial statements, depending upon the nature of the inventory figures, namely, those with actual inventories, computed in any one of

several ways described herein below, and those indicating the balancing inventory required to break even. If appropriate account designations and notations are made, those with actual inventory figures may properly be called financial statements and the exhibits labeled "balance sheet," "statement of operations," or other conventional titles. On the other hand, those that contain inventory-balancing figures should be qualified as "statement of assets and liabilities with inventory needed to break even," "statement of income, costs and expenses with inventory needed to break even," or similar titles indicating the incomplete nature of the statement.

The validity and usefulness of monthly financial statements depends first upon the preparation of an annual verified report as a starting point, and then upon the quality of the monthly audit. Of equal importance are the frequency of physical or "book" inventories following the verified, annual physical inventory, and the soundness of the technique used for estimating interim inventories where perpetual inventory systems are not maintained. Submission of interim statements with estimated or "break-even" inventories, particularly the former, without corroboration by an actual physical inventory for more than six months, is a highly risky procedure and should be avoided.

Interim Inventories

In the most rudimentary of double-entry bookkeeping systems, all of the asset and liability accounts are or can be adjusted monthly for current transactions and thus kept up-to-date, except inventories which, to be adjusted monthly or periodically, require special systems and records. Most small firms, have neither integrated cost systems nor full perpetual inventory systems oriented to the accounting report. As a result, the opening inventory generally remains constant on the books for an entire year and is adjusted only on the monthly accounting reports.

For the purposes of this discussion, there are four basic types of inventories used in all financial statements:

1. *Physical* inventory verified independently by the CPA.

2. Inventory *submitted* by management, either physical or from reliable detailed perpetual inventory records (i.e., "book" inventories).

3. Inventory *estimated* through costing of sales or by the gross profit method based upon past experience and/or knowledge of current costs.

4. Inventory *needed to break even.*

The verified physical inventory, of course, is a procedure antecedent to the preparation of a fully verified report. In most firms it appears only on the annual statement. Usually interim reports contain either "submitted" or "estimated" inventories, or balancing "break-even" inventories. If perpetual inventory records are kept and the CPA determines the adequacy of periodic physical test-checks, monthly schedules can be taken, priced, and submitted by management for inclusion in the monthly report. If perpetual inventory records are not kept, physical inventories should be taken, and the original data should be submitted to the accountant by management as frequently as feasible. As a general rule, a single figure without supporting details should not be accepted by the CPA for inclusion in the interim report. The significance of interim reports, as stated previously, is at best substantially reduced without either properly administered perpetual inventories or at least semi-annual physical inventories.

In dealing with small firms, inventory-taking is a continuing process of education of management by the CPA. This is true particularly in the case of interim inventories in the supervision or control of which the accountant normally does not directly participate. Such matters as cut-off controls, pricing techniques, and even the over-all control of the physical count or the summary of records of inventories on the premises of bailees continually require special attention and guidance by the accountant.

Interim submitted inventories, either book or physical, although not physically verified, should be audited by the CPA for arithmetical accuracy. They should be examined for consistency with purchases, purchase returns, sales and sales returns records to guard against inadvertent omissions or duplications. In addition, valuations should be reviewed particularly with respect to spoiled and obsolete merchandise. Knowledge of the client's circumstances, motives, and personnel is, of course, an important factor in judging the extent of audit required of submitted inventories.

Where monthly reports are prepared, and submitted inventories are not available each month, either estimated or break-even inventories must be used. A reliable estimate, either through a continued internal costing of sales (preferably) or through the use of the gross profit method, generally computed by the CPA, is usually more meaningful than a break-even inventory; if carefully prepared, it reflects an up-to-date estimate both of the financial position and the month-to-month progress of the company. If the estimate is made by costing sales, however, it should be remembered that the resultant inventory is at cost and, therefore, must be reviewed and adjusted for significant market price declines and losses from obsolescence or inferior production. If the gross profit method is used, the rate of gross profit should be computed not only from prior experience but also from pre-production cost estimates and actual going cost data; and proper allowance for reductions in gross profit resulting from off-price sales must be made based upon review of the month's sales, discussions with the client, and general familiarity with business. Gross profit estimates should be computed separately for each month and the reported operations for the fiscal period to the interim date should reflect the accumulation of the monthly figures. A physical or sight estimate by management of the total value of the inventory is useful only as a rough basis of comparison with estimated or break-even inventories but should not be quoted in the report itself.

The inclusion of balancing inventories or inventories required to break even on monthly financial reports is a common practice. Statements containing such inventories are less useful than those containing actual or estimated inventories, since they do not provide a complete picture of the financial positon or operations. However, in some circumstances, where a reasonable basis for estimating an interim inventory is not available, a statement with a break-even inventory may be the only kind that can be prepared. It should be noted, however, that even a properly labeled break-even inventory is, in a sense, misleading, if substantial and significant losses are known to have been sustained by the company.

The CPA must recognize that the inventory figure presented on an interim financial statement will have significance to the reader and its importance should not be minimized simply because it is reflected in an interim report.

Telephone and Other Direct Communications from Credit Grantors

Credit evaluations and determinations must be made quickly for the benefit of both buyer and seller. Credit agency rating books, reports, and company credit files and experience are not always adequate or current. As a result, the procedure of communicating directly with accountants, usually by telephone, has been adopted by credit men. In some industries, notably "soft goods," mercantile and commercial factoring companies have engaged credit assistants to devote their time exclusively to telephoning accountants and recording financial information thus procured on special forms for quick analysis.

From the point of view of the ethical aspects of the profession pertaining to the client-accountant confidential relationship, the direct line of communication between the CPA and the credit grantor is established by the client. It begins either voluntarily or at the request of the credit grantor, when the client gives the name of his accountant as a credit reference. Sometimes, the financial statement form submitted by a banker, commercial credit grantor, or credit agency contains a paragraph in which the client specifically agrees to permit direct communication with his accountant for supplemental financial information.* Frequently, the client himself encourages the credit grantor to communicate with the accountant. In the "soft goods" industries, the practice of direct communication between accountants and credit grantors has evolved to a point where, in the case of clients relying heavily on credit, the accountant may list among the prerequisites to the acceptance of a new engagement blanket authorization to respond to proper credit inquiries without specific consultation with the client. In fact, an increasing number of CPA firms have adopted form letters which clients are requested to sign for this purpose. This is not to say that a new engagement will be rejected unless such latitude is granted; but, where the client intends to list the CPA as a credit reference, he surely must give the latter the flexibility of judgment necessary to assure third parties of proper reporting and full disclosure.

Direct inquiries by credit grantors of accountants, generally, are designed to secure financial data not published on credit agency forms but included, perhaps, in the annual long-form report, together with information regarding post-balance-sheet events, and/or data contained in interim financial statements. Depending upon the nature of the request, the amount of credit involved, the financial position of the client, and other pertinent circumstances, these inquiries frequently are answered verbally over the telephone. Sometimes, however, they may require special consultation with the client and, perhaps, the forwarding of a copy of the long-form annual report or an interim financial statement. In answering a direct credit inquiry, the accountant should limit his presentation to facts and figures, and avoid any prognostication, speculation, or direct effort to influence the decision of the inquirer.

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* The following is quoted from the section of the financial statement form of National Credit Office, Inc. in which the signature of the company appears:

"The undersigned warrants that the foregoing figures and answers are true and accurate in every respect and orders this statement mailed to you with the intention that it shall be relied upon in the extension of credit or insurance by such concerns, including factors or agents, who may subscribe to your service now or hereafter. My (Our) accountants are authorized to supply you with any supplementary information that may be required."

Clients sometimes request their accountants to telephone credit grantors to influence their credit decisions. In general, the CPA should avoid placing himself in the position of advocate. The client's interests are best served if the request for information comes from the credit grantor and the CPA responds as an independent observer. If the call must be made by the CPA, he should exert every effort to maintain the same neutral position as if the call had originated on the other side.

Solicitation of Credit and Participation in Credit Conferences

In his normal contact with credit grantors, the position of the accountant should be impersonal and objective. Nevertheless, where a client is seeking a disproportionately large amount of credit, the credit grantor may request a personal meeting with the accountant, sometimes in the company of the client and sometimes not, for the purpose of closer study of available accounting information. In order to augment his understanding of the client's financial affairs, he may question the accountant regarding costs, break-even point, budgets and projections, and other aspects of the business which the CPA will be expected to know but which are not reflected in the financial reports. Part of his purpose may even be to assure himself that the CPA is sufficiently intimate with the client's affairs to render appropriate advice. His confidence in the CPA, even though the latter remains completely independent and objective, will influence his credit judgment.

A visit by the CPA to a credit man, unaccompanied by the client, should, of course, take place only with the knowledge and approval of the client. Whether or not made in the presence of the client, affirmative statements by the CPA should be based completely upon facts. Where budgets or other prognostications are discussed, his statements should be properly qualified and should be rendered with an oral disclaimer, if applicable, much the same way as a written prognostication would carry a disclaimer. In short, his attitude and approach should be guided by the same reporting standards as apply in the preparation of a written accounting report.

Guarantees and Subordinations

The subjects of guarantees and subordinations often are considered together. From an accounting point of view, however, their effects are quite different. A personal guarantee by an officer or principal stockholder of a corporate liability has no direct bearing upon the financial position of the company. The subordination of a debt by a creditor, however, serves immediately to enhance the balance sheet position for the creditors to whose claims the subordination is made. From a legal point of view, a general subordination with an indefinite termination date is almost the equivalent of capitalization of a debt. Often, the only reason for subordinating stockholder loans instead of capitalizing them is to avoid the otherwise inevitable income tax on dividends when the corporation, having replaced the working capital through earnings, is ultimately able to repay the loans.

Personal guarantees not only have no effect on the balance sheet of the debtor company, but in most cases are given only to individual creditors, and then in strict confidence, sometimes without even the knowledge of the auditor. Subordinated liabilities, on the other hand, particularly stockholder loans, frequently appear on balance sheets of corporations entirely unsolicited by creditors, in anticipation of credit prob-

lems, where a corporation is otherwise undercapitalized and stockholders desire to enhance its financial position. Often, a decision to subordinate stockholders' claims is made upon the advice of the CPA based upon his understanding of the financial position and credit needs of the company.

A subordination by one creditor to another has, in itself, no material effect on the balance sheet status of the liability, except from the point of view of the two parties involved, and may not even require disclosure. However, a liability subject to a general subordination should be segregated below other liabilities with full disclosure as to the term of the subordination and other pertinent facts. Although there is no particular authority for the practice, liabilities to stockholders, subordinated without qualification for indefinite periods, sometimes are included with stockholders' equity in a properly designated section of the balance sheet.

Requests for guarantees, and sometimes for subordinations, generally occur in instances where credit grantors consider the credit accommodations sought to be excessive compared with the working capital and the general financial position of the company. The accountant, if called upon by an inexperienced client for advice regarding such requests, can only explain the reasons in these terms. In the final analysis, the client must evaluate his own bargaining position. If the credit grantor insists upon the guarantee or subordination, the customer or borrower either complies or seeks the credit elsewhere.

Acceptance of Engagements, Withdrawals and Minimum Standards of Practice

As previously pointed out, credit grantors, in extending credit, particularly in the "soft goods" industries, weigh heavily the reputations of the accountants serving their customers. In some instances, credit is extended even prior to the promulgation of financial information merely on the assumption that the accountant has used wise judgment in accepting the engagement and associating his name with the client. One may justly protest that this kind of presumption is unwise and unsound; yet it is typical of the attitude of a segment of the profession's public. To oppose it absolutely is simply opposing public opinion. On the other hand, if the profession accepts the broader responsibilities expressed or implied here and elsewhere in this article, it must adopt appropriate principles to guide the conduct of practices oriented to the banking and credit fraternity and provide its own definitions of its duties and limitations.

The following are some suggested basic rules:

1. Before acceptance of any engagement, where there is a question of credit, endeavor to determine in a general way the financial standing of the company and the background and reputation of the management and principal stockholders. This usually can be accomplished initially through the reading of a recent credit agency report.

2. As soon as possible after the commencement of the engagement, prepare statements based at least upon a physical inventory and, preferably, upon an examination leading to an unqualified opinion.

3. If the initial statement reflects a weak financial position, relatively large inventory, or heavy indebtedness, make a reasonable attempt to determine the possibility of improving the situation.

4. If the initial statement reflects an insolvent financial position, or the prospective client is known in advance to be insolvent, or if a downward trend is

apparent, remedial measures should immediately be recommended and a meeting arranged with the company's attorney and ultimately with appropriate creditors. Unless such advice is accepted by the client, the accountant would be wise to reject the engagement.

5. An understanding with respect to the scope of the engagement and the minimum procedures required should be conveyed to the new client at the outset. In most cases, these would include the following:

(a) A fully verified, preferably long-form report, at least annually.

(b) Frequent (generally monthly) interim audit and report.

(c) At least semi-annual physical inventories, or the equivalent from inventory records.

6. An understanding with respect to the necessary latitude of judgment permitted the CPA in answering inquiries of banks and mercantile credit grantors should be reached initially. Such latitude should include full and unlimited disclosure of all relevant facts in answer to proper inquiries, interim as well as annual.

7. On the basis of the scope of the engagement described, an adequate fee should be estimated and stated in a frank manner. Once the engagement is undertaken, inadequate compensation cannot be considered a valid excuse for failure to follow required professional procedures.

The withdrawal from an engagement by a CPA, in the type of practice considered here, beyond non-professional considerations, will generally be necessitated by:

1. Fraudulent or unethical practices by the client.

2. Refusal of client to permit the CPA to perform minimum procedures of the type previously described.

3. Acts or omissions leading toward business failure in disregard of the recommendations of the CPA, where the essential capital of a company is in jeopardy. (The specific problem of withdrawals from engagements where the clients are insolvent will be dealt with in the next section of this article.

Because of the significance of the accountant's name to the client's credit standing, it is a wise although by no means universal practice for the accountant to announce his withdrawal from an engagement through the credit agency active in the industry. This practice is particularly desirable where the reasons for the withdrawal are such that a complete dissociation is expedient. The agency is informed via a letter that states simply that the firm no longer is the accountant for the subject client. The reasons for the withdrawal should be omitted since normally their inclusion would breach professional confidence.

Insolvent Clients

Under the common law and most state laws, insolvency is defined broadly as the inability to pay one's debts as they mature irrespective of whether the capital section of the balance sheet reflects a deficit. The National Bankruptcy Act limits the definition of insolvency to the balance sheet definition, i.e., an excess of liabilities over assets. The CPA may judge a business to be virtually insolvent without its falling literally into either of these categories, where the conventional accounting valuations of assets that comprise the capital are excessive as compared with a realistic appraisal; such businesses often are able to liquidate their maturities as they occur because of either unsecured credit or secured financing.

Insolvency, fundamentally, is an accounting concept which the CPA is eminently well qualified to understand.

The problems related to the affairs of an insolvent debtor, while they generally require legal counsel and knowledge, occur in areas where an accountant's understanding of the financial aspects of business is indispensable. And the recognition of an insolvent company can be accomplished far sooner through competent accounting analysis than through, as it often is, the natural course of events.

It is not within the scope of this article to study in detail the causes and symptoms of insolvency and the specific ways in which the accountant can help to prevent it or prescribe appropriate remedial measures when it occurs. In general, however, it may be stated that the approach to accounting practice described in this article and the minimum procedures advocated are particularly suited to the recognition and the constructive handling of insolvent or financially embarrassed clients. Annual fully verified reports, frequent interim inventories, monthly financial statements with reliably estimated inventories, if actual counts are not available, cost analyses, systems review, budgets, and other procedures that keep the CPA continually informed of his client's current activities —these are the most effective tools with which the CPA is equipped to recognize and deal effectively with downward trends and other symptoms of impending financial crisis.

The mere fact that a client is in a precarious position should not influence the CPA to withdraw from the engagement, provided the client takes the necessary corrective measures in time to be effective. He should not, however, remain associated with a client that fails to cooperate to help himself, even though his resignation from the engagement may be looked upon critically by both client and credit grantors as the abandonment of a "sinking ship."

If a client becomes insolvent, the CPA can best serve his own as well as the client's interests, and those of creditors, if he convinces the client to consult with an attorney for the purpose of informing creditors of the condition. Morally, practically, and even legally, an insolvent company ultimately is the property of creditors. An accountant who remains with it, when its management will not consult with creditors, may be criticized for condoning the client's attitude. If the client is cooperative, the CPA can help creditors as well as the client by continuing to perform important accounting functions until the client is able to decide with his attorney what course of action to pursue. In no event, however, should he seek to represent his debtor-client in negotiations for a compromise settlement of liabilities; this function should be performed by an attorney.

In the "soft goods" industries, current policy among credit men is to replace the CPA at creditors' meetings, particularly if the debtor's balance sheet on a going concern basis reflects a deficiency to unsecured creditors. In anticipation of this policy, if the facts warrant it (i.e., liabilities exceed assets), it generally is expedient for the CPA to withdraw voluntarily after the completion of whatever work is required of him by the client's attorney; his remaining with the engagement beyond that point, as a practical matter, can only prove embarrassing and costly. The retention of a new accountant on behalf of creditors is for the expressed purpose of determining the existence of fraudulent conveyances, preferential payments, and other irregular transactions. The policies of credit men with respect to accountants for insolvent debtors are based upon the assumption that the independence of the accountant in an insolvency audit is impaired

by any prior associaton with the debtor. The federal court rules on bankruptcy procedure relating to the retention of accountants also imply this point of view.* It is doubtful that, even with the growing degree of mutual understanding between accountants and credit men, the accountant ever will be entirely immune from a share of the stigma of an insolvent client.

Independence and the Proposed Broadened CPA Responsibilities

The foregoing sections of this article have dealt with various recurring problems in the CPA-credit grantor relationship. The conclusion expressed or implied consistently throughout has been an expansion in the limits of professional activity and responsibility by the CPA when practicing among small or medium-sized clients who do not have internal accounting officers and staffs. This approach, perhaps, is in conflict with that maintained by both colleagues and laymen who continually have admonished the practitioner to remain within the bounds of his profession and not to confuse his position with that of a principal.

The fundamental question is, "Should the profession accept the role of business doctor?" Must we assume that an accountant who has injected his point of view into managerial decisions has impaired his independence? Can an accountant report independently on the outcome of business decisions that he has influenced or perhaps even prescribed? To resolve these questions, we must consider the matter from the point of view of the parties involved.

While there may be facts and circumstances that directly affect the problem in any given situation, fundamentally the concept of independence is a matter of attitude. There is no doubt that the practitioner who has influenced important decisions, and even the basic policies of his clients, cannot dissociate himself from the outcome of his recommendations. At the same time, however, he can and must view the activities of his clients objectively and realistically, and recognize that at times his remedies may be good but the situation hopeless, and, on rare occasions, even the remedies themselves may be inexpedient.

From the point of view of stockholders and management, on the other hand, the proposed broadened role and minimum standards of practice provide financial advisory services which small businesses require but rarely can derive from internal management. Furthermore, since stockholders and management generally are substantially the same individuals in the companies considered here, the matter of independence in relationship to possible conflicting interests between stockholders and management, is inapplicable.

Insofar as third parties are concerned, it may safely be stated that the approach indicated is at least in part a response to the demands of bankers and mercantile credit grantors, and certainly is consistent with their interpretation of independence.

Thus, if all of the parties concerned—the CPA, the client, and the credit grantor—accept the principles and practices herein described as being consistent both with the concept of independence and with the ultimate goals of professional practice, it may fairly be concluded that any ethical or other con-

* Rule 11, Subdivision A, Rules of the United States District Courts, Southern and Eastern Districts of New York. This rule requires that the accountant, in applying for retention under the bankruptcy act, disclose any previous affiliation with the debtor.

flict attributed to these principles and practices is unwarranted. And from the point of view of the profession as a whole and the general public, the proposals made in this article involve a firmer application of accounting, auditing and reporting standards and a more highly disciplined conception of the CPA's independence.

The question really is, "If a CPA conducts a practice among the type of client described herein without application of the concepts proposed, can he really consider himself independent?"

Audited Statements and Credit Granting

One of the principal uses of audited financial statements is for bank credit purposes. There is a gradually increasing acceptance by the larger banks of the assumption that financial statements certified by CPAs are an indispensable requirement of bank credit. I know of one bank in New York that has a rule: No certificate, no loan. Perhaps even in this bank this rule is not inviolable, and perhaps not many banks have such a rigorous requirement. But I think there is no doubt there is a gradual trend toward more and more pressure on bank borrowers to produce financial statements which the banker can accept as reliable. It seems to me inevitable that the smaller banks in the smaller communities in time will follow suit. Bank officers and directors take a certain amount of risk in failing to take advantage of all available safeguards in utilizing their depositors' funds and in their stewardship of the stockholders' capital. By educational processes, CPAs can do something to accelerate realization on the part of banks that the independent audit by a CPA is becoming a standard, accepted safeguard.

There are some signs that commercial credit grantors are scrutinizing financial statements in addition to analyzing the credit rating based on experience in paying bills of customers who are granted liberal credit terms. We hope the day will come when the credit rating agencies like Dun & Bradstreet will indicate clearly in their reports whether or not financial data presented has been audited by a CPA, and whether or not an unqualified opinion has been issued.

John L. Carey, "The Next Fifty Years,"
The Ohio CPA, Winter, 1959

Personal Property Taxation

By Arthur D. Lynn, Jr.

After a review of the development and present status of *ad valorem* personal property taxation, the author considers the assessment problem and assessment standards. The article suggests the need for the adoption of specific assessment standards that will provide workable and equitable methods for assessing tangible personal property.

Tax practitioners, normally immersed in the complications of the income - estate - gift tax complex, must on occasion advise clients about property tax compliance. As citizens sophisticated in tax matters, they will periodically be concerned with the present fiscal role and possible future modification of this revenue source. This article deals with *ad valorem* taxation of personal property; primary attention will be devoted to the taxation of tangible personal property used in business. No attention is given herein to the taxation of real property.

Arthur D. Lynn, Jr. *is Associate Professor of Economics at The Ohio State University, Columbus, Ohio. Professor Lynn is a member of the Ohio Bar, the Ohio State and American Bar Associations, the American Economic Association, the National Tax Association and the Tax Institute. He was Research Associate with the National Tax Association Committee on Personal Property Taxation in 1952-53 and is currently a member of the Committee on State and Local Taxes, Section of Taxation, American Bar Association.*

Historical Development

Property taxes are apparently almost as old as the institution of private property. They have been an important revenue source for local and/or state governments since colonial days. A quick look at some present personal property tax "systems," to use the word loosely, might lead the observer to the hypothesis that this tax was designed by a zealous but inexpert committee eager to complete its task and disperse for a long weekend. Such, of course, is not the case. Existing property tax patterns are the product of fiscal evolution which seems to move at a truly glacial rate. They can be explained best in historical terms.

Property taxes in the United States often began as *selective* levies. They gradually developed into uniform *ad valorem* taxes on all property, real or personal, that was not specifically exempted from taxation. The resultant so-called general property tax was the characteristic and most significant nineteenth century development in state and local taxation in the United States. The theory of the tax was simple. It was that the value of property owned, regardless of kind, character or legal

classification, was an adequate index of taxable capacity. This premise served passably, if not well, during much of the nineteenth century. As property interests became more complex with the development of an industrial economy, the old general property tax system was modified in state after state. Existing diversity in property tax patterns, particularly personal property, is the result of differential responses to the inadequacies of the old general property tax system. Since 1900 and more particularly since 1930, these responses have included: (1) exemption of personalty or particular categories of personalty, (2) classification of property for tax purposes, (3) substitution of in lieu taxes, (4) supplementation of property tax revenues by other forms of taxation at either the state or local level, (5) new patterns involving either increased state administrative responsibility or additional state supervision of local property tax administration, and (6) increased state aid to local governments. Changes in personal property taxation developed within this modified tax structure.

What is Personal Property?

During the dominance of general property taxation, legal distinctions between realty and personalty were simply immaterial. The same legal tax rules applied to both property categories. Even if administrative emphasis differentiated the two, this fact was only infrequently accorded legal recognition.

As soon as personal property, particularly tangible personalty, was granted differential tax status either as a result of exemption or by classification of property for tax purposes, the matter of definition became significant. It may be noted that the determination of what is realty and what is personalty is by no means entirely uniform in the several states. For instance, this matter has been the subject of considerable past litigation in Ohio.[1] The matter is now fairly well settled. However, the question of the effect of anomalies in the division between realty and personalty is one that should be considered by the property tax advisor. Tracing this division, jurisdiction by jurisdiction, is beyond the scope of this article.

Present Personal Property Tax Diversity

Existing personal property tax patterns are quite diverse. All states except Delaware, New York, and Pennsylvania tax at least some tangible personal property. In addition, some 34 states tax at least some intangible personalty. Descriptive generalization is difficult and less than perfectly accurate. However, at least five alternative personal property tax patterns are apparent. First, a few states adhere to the old general property tax. Such jurisdictions continue legal uniformity rules requiring undifferentiated all-inclusive taxation of personalty. When this is the case, extralegal administrative variation is not infrequent. Second, a few jurisdictions including New York exempt both tangible and intangible personal property from *ad valorem* taxation. In this case, the old general property tax is recast as a tax on realty only. However, given some breadth in the tax definition of real estate, the resultant tax may be more inclusive than one would initially suppose. Third, some states, for example Wisconsin and New Jersey, exempt intangible personalty but continue to tax tangible personal property under essentially the same legal rules that apply to real estate. At the time of this writing, this pattern has given rise to considerable debate in New Jersey.[2] Fourth, an alternative pattern includes special low rate taxation of intangibles while tangibles are subject to real estate

tax uniformity requirements. Fifth, yet other states, including Kentucky, Minnesota, Montana, Ohio, Virginia and West Virginia, have adopted comprehensive classification systems for *ad valorem* tax purposes. Therein, a number of classes of personalty, both tangible and intangible, are distinguished and granted alternative tax treatment.

If the above classification of existing personal property tax patterns seems either prolix or complex, it should be noted that it constitutes a mere generalization. There are 48 sets of property tax laws with numerous minor as well as major variations. Also, within any given state, there may be, and ordinarily is, some extralegal administrative variation particularly at the local government level. This frequently can only be ascertained by observation of local fiscal habits and administrative practices. This situation often does not realize the *certainty* that Adam Smith posited long ago as a desirable canon of taxation; nor does it achieve that predictability which is a desirable legal norm. However, shotgun criticism of property taxation is neither new nor novel. It can ignore neither the present essentiality of the tax to local government nor the limited progress made as a result of property classification and administrative improvement. The balance of this article will consider more concrete problems of personal property taxation.

Personal Property Tax Problems

Most practical personal property (particularly tangible personal property) tax problems arise in the form of one or another of several basic questions. These include: (1) What property is subject to taxation in a given jurisdiction? (2) To what extent does a levying state or local government have jurisdiction in a particular instance? (3) What is the legal basis for assessment of taxable personalty? (4) What is the actual administrative practice with respect to the listing and assessment of apparently taxable personalty? (5) What are the possibilities for relief individually or as a result of changes in tax policy? Once these questions are resolved, the remainder of the property tax compliance job seems important but pedestrian. Basic questions about the time of accrual of tax liability and the manner and method of payment are best answered by reference to relevant statutory materials or tax services for any given jurisdiction.

Jurisdiction and Exemption

Brief commentary can hardly explore the varying legal rules about jurisdiction to tax personalty *ad valorem;* nor would such intricacy give material aid to the tax accountant. The older rule was simply that tangible personalty was taxable at the domicile of the owner. As industrial property patterns have become more complex, some jurisdictions have supplemented the older approach with the rule that property which has acquired a business situs within the taxing jurisdiction is taxable therein. So the wag may say, "Death and Taxes are certain but what of Situs?" Double taxation based on combinations of domiciliary and situs claims to jurisdiction does occur.

Similarly, the exact boundary lines of exemptions are a perennial problem. The usual property tax exemption of property used for religious, educational, or charitable purposes presents occasional problems even to the business taxpayer. More relevant, however, are the variable limits of exemptions applicable to goods in transit, goods in storage owned by a non-resident, and goods in storage for out-of-state shipment. Careful analysis of exemptions applicable to such situations may lead to the discovery

of relevant tax minimization possibilities.

Assessment—Legal Standards

While the ideas noted above could be developed at length, they are most effectively ascertained in relation to a specific problem or procedure. On the other hand, no discussion of *ad valorem* taxation, however circumscribed, would be complete without consideration of the assessment problem. So much has been said on this score during the last century that it would be difficult to add anything fundamentally new to the accumulated assessment archives. Accordingly, the following comments will notice the problem, comment on two opposite approaches evident in recent judicial decisions, and make one basic suggestion about assessment standards.

Dissatisfaction with the valuation of property including personal property for *ad valorem* tax purposes is perennial. The situation giving rise to such dissatisfaction appears to stem from: (1) imperfectly or inadequately stated legal assessment standards, (2) ineffective organization for performance of the assessment function, (3) poor assessment performance, and (4) public apathy or preference for the tax *status quo* despite its various drawbacks.

Considering these points in the order stated, it is well known that the usual assessment standard provided by law for property tax purposes directs that taxable property be valued at its "fair value," "full value," "true value," or some similar general statement. Such standards are imprecise; the touchstone is ephemeral. No effective guidance is given the assessor by such standards; he is left to use his own judgment limited by the varying force of judicial review and political reality. Yet, except in fiscal emergencies, little interest develops about the problem of finding and stating effective assessment standards.

Likewise, it is obvious that assessment units and patterns developed in response to the fiscal needs of an eighteenth or nineteenth century agricultural economy are unlikely to be well designed for present administrative purposes. Adequately sized assessment districts, large enough to support trained, competent staff personnel, seem a *sine qua non* to effective performance of the assessment function.

Poor assessment performance, the third point noted above, naturally derives from the absence of assessment standards and a poor organizational basis for doing the job. If there is ever surprise about the state of property tax assessments, it should usually be based on amazement that the job is as well done as it is under the circumstances. It is small wonder that underassessment and/or unequal assessment has often come to be the rule rather than the exception.

Toleration of the property tax *status quo* appears to be a function of public apathy. However, correcting errors also will tend to change any existing distribution of tax burdens to the disadvantage of someone. This probability, coupled with uncertainty about just what changes might actually happen, naturally may lead to support for any existing tax pattern on essentially self-interest grounds.

Administrative Practice—Negotiation

Within the situation above described, assessment may be a matter of negotiation rather than the uniform application of effective fiscal rules to factual situations. The beneficiary of tax negotiation seldom complains. The less fortunate taxpayer's complaints are reflected in the legal reports. Examination of a small collection of cases in states,

relatively near to New York, in which tangible personalty is taxable *ad valorem,* will give striking evidence of the currency of the problems already generally discussed herein.

Ingraham Company v. *Bristol,* 144 Conn. 374, 132 A2d 563 (1957), is illustrative. The court found that the city assessor of Bristol, Connecticut, had assessed real estate at fifty per cent of market value and had assessed taxable tangible personalty, with the exception of automobiles, at ninety per cent of market value. In its opinion, the court noted: "The assessing of property at a fraction of its actual value undoubtedly is so widespread that most, if not all, of the municipalities in the state pursue the practice. This rule of assessment has been tolerated for so long a time that it has acquired the respectability of assumed legality. The practice, however, is clearly improper." (132 A2d 563 at 565.) The court denied the taxpayer relief and refused to reduce the assessment on the theory that this would violate the relevant Connecticut full value statute. While this decision failed to provide the taxpayer immediate relief, it did, in effect, declare that the existing complex of assessment practices were unlawful where the result was less than full value assessment.

This decision represents one of two alternative judicial approaches to the harsh realities of property tax assessment practices. The literal concept of the law—full value—is applied. Subsequent to the decision in the *Bristol* case, the Connecticut legislature enacted a stop-gap law which authorizes assessment of real and personal property at any percentage of full value not exceeding one-hundred per cent provided that realty and personalty are accorded uniform treatment. (See P. Act. 673, Conn. 1957.) It would seem probable that strict compliance with the new law would be an administrative problem.

By way of contrast, in *Sears Roebuck & Company* v. *State Tax Commission of Maryland,* 214 Md. 550, 136 A2d 567 (1957), noted 18 Md. L. Rev. 66 (1958), the court granted assessment relief. In this case, the assessor had valued retailer's stock in trade at "full cash value" by determining its "fair average value" for the twelve months preceding tax listing day. This was presumably in accord with the relevant and applicable Maryland statutes. However, in the assessment of realty, a deduction from the valuation was made of amounts which resulted from inflationary influences. This was not done in the case of retailer's inventory. The failure to do so was considered a violation of basic property tax uniformity requirements by the Maryland court.

This pair of cases illustrates the judicial aspect of the property tax assessment problem. There is, in such cases, an inevitable conflict between uniformity objectives and requirements on the one hand and basic notions of fairness and equity on the other. (The interested reader might examine *Sioux City Bridge Company* v. *Dakota County,* 260 U. S. 441, 1STC Par. 440 ('23).) Hard cases make bad law and the ultimate resolution of the problem would seem to be a legislative rather than a judicial problem. Legislative adoption of assessment standards would seem the best way to introduce assessment certainty and objectivity where *ad valorem* personal property tax is retained as a matter of fiscal expediency. The matter of assessment standards will be the next subject considered herein.

Assessment Standards

Legal assessment standards often have given a superficial appearance of precision to property taxation. Administrative practice usually has been variable and uncertain. At times, assessment has been little more than a farce. Judicial

review has either granted relief to individual taxpayers by reducing assessments or has opted for full value assessment. (See, e.g., *Switz* v. *Middletown Township*, 23 N. J. 580 (1957).) Neither approach grapples effectively with the administrative problem of how to achieve both assessment uniformity and rapid, economical appraisal.

There are two basic approaches to effective assessment. One is technical appraisal where property is valued item by item. While this approach affords the closest approximation of the legal full value assessment standard, it is usually too slow and too costly. A second assessment technique consists of the application of standardized valuation methods to existing business records. This second method is economical, rapid, and secures approximate uniformity. In the writer's opinion, much of the existing personal property tax problem could be quickly solved by: (1) exempting such personalty as is never going to be effectively taxed, and (2) prescribing a definite value standard for the assessment of the taxable residue. These two potential policies will now be considered.

Exemption of Specific Categories of Tangible Personalty

Experience seems to demonstrate that tangible personal property not used in business or agriculture is seldom taxed effectively. While there is no theoretical reason why it could not be effectively taxed, the actual fact is that it is not so taxed. Accordingly, such property, particularly household goods, might as well be exempted in law as well as in practice. This appears to be the trend.

A more difficult question arises with respect to *ad valorem* taxation of tangible personal property used in business. In 1953, the National Tax Association Committee on Personal Property Taxation[3] included the following carefully considered statement in its final report:

> To the extent that substitute taxes on business can be adopted, *ad valorem* taxation of tangible personal property used in business should be eliminated or at least reduced. (*Proc. Nat'l. Tax Ass'n.*, 1953, p. 406.)

While the suggested exemption of business personalty has appeal, harsh fiscal realities and inertia tend to overbalance the logical persuasiveness of exemption proposals. The revenue loss from complete exemption or the shock of adoption of substitute revenue sources is too great to permit easy adoption of a complete exemption policy. (See, e.g., *Ninth Report of the* [New Jersey] *Commission on State Tax Policy*, (1958) pp. 109-114, esp. 112.)

Accordingly, the question arises as to what categories of business personalty might appropriately be exempted. Both the National Tax Association Personal Property Tax Committee and the New Jersey Commission on State Tax Policy have suggested exempting inventories (current assets) while leaving machinery and equipment (depreciable assets) taxable. (See, e.g., *Proc. Nat'l. Tax Ass'n.*, 1953, pp. 366-367.) There is, I think, considerable merit in this suggestion. The worst elements of the problem or the entire personal property tax problem could be solved by exemption; however, as long as revenue needs are great and adoption of in-lieu taxes controversial, it would seem probable that some tangible personal property will remain taxable *ad valorem*.

Conclusion

Where this is the case, a substantial tax problem will continue to exist as long as specific assessment standards are not prescribed. Space will not permit a lengthy analysis of this problem. It is reasonably clear that no simple, quick, and, at the same time, economical

short cut to market value is to be found; however, adequately workable substitute methods for assessing tangible personal property are available. *Ohio Revised Code,* Section 5711.18 (in part) provides an example, as follows:

> In the case of personal property used in business, the book value thereof less book depreciation at such time shall be listed, and such depreciated book value shall be taken as the true value of such property, unless the assessor finds that such depreciated book value is greater or less than the true value of such property in money.

It will be noted that this section provides a prima-facie value standard but that it also safeguards the procedural rights of both the taxpayer and the tax administrator. Few would assert that the depreciated book value standard for the assessment of taxable tangible personalty is perfect. The Ohio experience does suggest that it provides a workable solution to the assessment problem for this type of property. Accordingly, when some or all tangible personalty is to be taxed *ad valorem,* the depreciated book value standard can be recommended to those jurisdictions presently without explicit legal assessment standards other than statutory full value statements.

Two years ago Mr. George W. Mitchell of the Federal Reserve Bank of Chicago, speaking at the annual conference of the National Tax Association, predicted that twenty years hence the property tax will be much less important. He stated, "The property tax will by then have become an all-but-forgotten relic of an earlier fiscal age." (*Proc. Nat'l. Tax Ass'n.,* 1956, p. 494.) On occasion, the tax adviser may wish that Mr. Mitchell's prediction were true already. However that may be, in the interim until the personal property tax fades away, the accountant would seem well advised to support the development and adoption of rational, known, and rather mechanical assessment standards.

References

1. See *Zangerle* v. *Standard Oil Company,* 144 Ohio St. 506, 60 N.E. 2d 52 (1945); *Roseville Pottery, Inc.* v. *County Board of Revision,* 149 Ohio St. 89, 77 N.E. 2d 608 (1948); *Reed* v. *County Board of Revision,* 152 Ohio St. 207, 88 N.E. 2d 701 (1948); Holden, "Classification of Property as Real or Personal for Ohio Property Taxes: An Appraisal," 11 *Ohio St. L. J.* 153 (1950).

2. State of New Jersey, Ninth Report of The Commission on State Tax Policy, The General Property Tax in 1958, Trenton, New Jersey (1958). See also Fifth Report of The Commission on State Tax,Policy (1950).

3. National Tax Association: The Taxation of Tangible Personal Property Used in Business (1952), and Report of the Committee on Personal Property Taxation on Possible Substitutes for Ad Valorem Taxation of Tangible Personal Property Used in Business (1953); NTA Proceedings, 1952 and 1953.

Supervision and Management Services

Adequate supervision is one of our most important auditing standards. It calls for the one who supervises to have adequate technical training and proficiency, and requires that the accountant not attempt to perform services outside his competence. While standards comparable to auditing standards have not been prepared with respect to management services, unquestionably such standards will be prepared in due time. It seems certain that the standard of adequate supervision will not be omitted from them.

James E. Hammond, "The CPA in the Field of Management Services," The California CPA, February 1959

Society Release

Dedication of Haskins Memorial Room

Resolution of Dedication

WHEREAS, Charles Waldo Haskins was appointed a member of the first State Board of Certified Public Accountant Examiners and at the Board's first meeting was named President, a position he retained until his death, and thus became one of the founders of the profession in the State of New York, and

WHEREAS, Charles Waldo Haskins, realizing that any profession must be organized and self-regulating to further its aims and aspirations, was instrumental in founding The New York State Society of Certified Public Accountants and became its first President, and

WHEREAS, Charles Waldo Haskins, recognizing the profession's need for formal preparatory education, conferred with the Trustees of New York University and finally achieved the establishment on October 2, 1900, of its School of Commerce, Accounts and Finance, of which he was named Dean and Professor of the History of Accountancy, and

WHEREAS, the Board of Directors of The New York State Society of Certified Public Accountants, after full deliberation, in acknowledgment of the debt owed to Charles Waldo Haskins for his contribution to the profession in securing legal recognition and regulation, in establishing self-imposed disciplines, in providing suitable preparatory education, and for his constant inspiration and continuing influence, it was

RESOLVED: That the Board of Directors formally authorize the dedication of the meeting rooms of the Society as the Haskins Room in perpetual memory of the man to whom so much is owed, and

BE IT FURTHER RESOLVED: That a copy of this resolution, suitably engrossed, be presented to the Haskins and Sells Foundation in honored memory of Charles Waldo Haskins and in grateful commemoration of this occasion.

IN WITNESS WHEREOF we hereunto subscribed our names and affixed the seal of The New York State Society of Certified Public Accountants.

HOWARD A. WITHEY
President

EDWARD L. LAWSON
Secretary

April 15, 1959

Charles Waldo Haskins
BIOGRAPHICAL SKETCH

CHARLES WALDO HASKINS was born January 11, 1852 in Brooklyn, New York. Graduated at 15 from Polytechnic Institute of Brooklyn. Predictions were for a future in civil engineering, his parents' choice of profession for him, but this became less alluring as he considered it.

He secured a position in the accounting department of the old and highly reputed importing house of Frederick Butterfield & Company, New York City. There he served five years, which was his apprenticeship in accounting.

To determine for himself what he wanted to do, he then went abroad. He spent two years in Paris studying art, for which he had both taste and talent, and made a tour of Europe.

He returned to New York and entered Wall Street, forming a temporary connection with his father's banking and brokerage firm. In his earlier business experience he had seen the relationship of accountancy to foreign trade and all its multiform phases and problems. Now, in Wall Street the figures were connected with finance and the rise and fall of stocks. He was soon to see the spell that figures exercised in relation to railroad construction, transportation activities and business enterprises, with their multiplicity of details, all finally expressed in a series of figures.

Accountancy was in its infancy in the United States. It required a man of vision to see what it might become. Mr. Haskins had this vision. With the imagination of a poet and the intuition of a prophet, he realized what accountancy could become, and he determined to do his part toward vitalizing it to the fulfillment of its destiny.

A red-letter day in his life was that day in 1886 when he opened an office of his own in New York City and entered the profession of public accountancy. In the several years following, he also held numerous important executive positions. He served as secretary of the Manhattan Trust Company and of the Old Dominion Construction Company, as comptroller of the Ocean Steamship Company, of the Chesapeake and Western Railroad, and as receiver of the Augusta Mining and Investment Company.

In 1893, Charles Waldo Haskins and Elijah Watt Sells met in Washington. Two men of strong individuality and of differing characteristics, previously unaware even of the existence of the other, met almost by chance and formed a lifelong friendship and rare kind of mutually motivated partnership.

With a third expert, these two men had been selected to assist the "Dockery Commission" which was created in 1893 by Congress and authorized to investigate the status of laws organizing the Executive Departments, to examine the operation of employes and methods and to recommend improvements. The work required not only accounting ability and business knowledge and experience in relation to the conduct of great corporations—for they were investigating the accounting system of the United States Government—but also keen analysis, clear judgment, and infinite tact and wisdom in the handling of men and measures.

Investigations had been many, had come and gone with no results, and were considered expensive but harmless. One Senator expressed the general view: "Oh, it's all right; it amuses Dockery and doesn't do any harm."

The atmosphere soon changed. The Joint Commission proved itself a real force. The recommendations of the experts were so clear, final, and self-evident in their business common sense that one bill after another reported by the Commission to Congress went through, or became in force by regulations or orders. Many reforms were put into effect in all departments, especially in the Treasury, Post Office and the Interior Departments, at savings of several hundred thousand dollars annually.

During the closing weeks of their work on behalf of the Commission, Mr.

Haskins and Mr. Sells discussed their future plans, and on March 4, 1895, they opened an office at No. 2 Nassau Street, New York, under the firm name of Haskins & Sells.

Mr. Haskins was one of the leaders in the profession of accountancy who were responsible for securing the passage in New York in 1896 of legislation regulating the profession of public accountants, providing for a class of public expert accountants to be known as "certified public accountants" with exclusive right to use the three letters "C.P.A." and authorizing the Regents of the University to establish examinations and issue certificates.

Mr. Haskins' partner, Elijah Watt Sells, was convinced that Mr. Haskins should continue his work for the strengthening of the young profession and believed that Mr. Haskins should be on the new Board of Examiners. He set in action a plan which resulted in the Regents being confronted with an overwhelming stack of telegrams, endorsements of Mr. Haskins from the most influential men in New York. Mr. Haskins was unanimously elected by the Regents. At the first meeting of the Examiners, Mr. Haskins was made president, a position he retained until his death.

In the spring of 1897, he helped to organize the New York State Society of Certified Public Accountants and became its first president.

There was a recognized need for a school of accountancy. At a Society meeting in November 1899, President Haskins was requested to confer with the Trustees of New York University for the purpose of arranging for a class for technical study in accountancy and related subjects. After much struggle the matter received consideration and finally resulted in the foundation of the New York University School of Commerce, Accounts, and Finance. To Mr. Haskins, more than to any other one man, is due the credit for carrying it through.

On Tuesday, October 2, 1900, the new school began its pioneer work in the University building in Washington Square, New York. A number of excellent speeches were delivered by Chancellor MacCracken, Colonel Sprague, and other members of the faculty. Then the first Dean of the School, Mr. Haskins, gave his first lecture as Professor of the History of Accountancy. There were about fifty matriculants in attendance at this opening session.

Soon after this the University conferred on him the degree of Master of Arts. The Chancellor told him that, because his relation to the school had to do with business and not with the recognized sciences, his acknowledgment of the degree in English would be acceptable. However, Mr. Haskins preferred to conform to the tradition of the University and gracefully acknowledged the honor in Latin.

He was deeply interested in the history of accounting, tracing it back almost to primitive man. From the notched stick, the knotted string, or the scratched piece of clay to the elaborate modern systems of accounts is a wondrous process of evolution. The subject was never a dry one to Mr. Haskins or to those who heard his lectures, addresses and informal talks. He loved the subject and planned to write an elaborate History of Accountancy.

Mr. Haskins has been described as "of stalwart physique, vital, pulsing with health and good spirits, kindly, cordial and hearty in manner, magnetic in personality, making friends readily and holding them strongly, as was attested by the popularity he won in the twenty or more clubs, societies and associations of which he was a member."

His firm has moved steadily forward, the School of Commerce has flourished beyond any dream of his, and the State Society has increased in size and stature. No man who does real work for the world ever sees the full fruitage of his efforts. He does not realize the seeding of purpose, initiative, influence, and inspiration that mean constant new harvests after he is no longer present to see and to know.

On January 9, 1903, Mr. Haskins' death followed a short sudden illness. He was buried on January 11, his fifty-first birthday anniversary.

Public Relations and the Accounting Profession

Public relations for chartered accountants is no more or less than trying to improve relations with associates, employees, clients, prospective students and their families, educational and government authorities, and the general public. It must work inside as well as out. Like charity, it begins at home. This means that, aside from and before any planned program at the national or provincial levels, every member of the profession should recognize his function as a public relations agent and consciously practice the art.

Many chartered accountants shy away from personal public relations, thinking perhaps that it involves a display of extroversion which would be better left to someone else. Perhaps they do not understand its importance or modestly consider they do not aspire to great personal prestige. A chartered accountant tends, by nature, to be modest and conservative. He may dislike having to talk about himself and does not fully appreciate the significance of his service or achievements. No one can build good public relations without having confidence in his "product" in the first place, and the chartered accountant should begin by realizing the importance of his professional work not only to his client but to the community and to the nation. The accounting profession has played a vital role in the development of the national economy and the business welfare of Main Street. No one would dispute that modern business and government, with their complexities, could not function without the contribution made by the chartered accountant. . . .

In his modesty, he has also been unduly reticent in expressing himself privately or publicly on general business affairs. Yet, by his training, broad experience and familiarity with the ramifications of all kinds of business, he is well qualified to comment. Were he to recognize more fully his qualifications, shed some of his reticence of self-expression, and identify himself more closely with the profession, he would command a greater respect for himself and for the profession of which he is a member.

EDITORIAL, "Public Relations and the Accounting Profession."
THE CANADIAN CHARTERED ACCOUNTANT, March 1959

Punched Tape Data Processing for Smaller Business

By Donald A. Schwartz, CPA

New developments in the use of punched tape together with new techniques in the operation of tabulating service bureaus have opened the door to low-cost electronic data processing for smaller business.

While large corporations make use of new "electronic brains" to reduce clerical cost and increase operating efficiency, the smaller company is unable to take advantage of such equipment because of its prohibitive cost. Yet the need for reducing overhead and improving customer service is as vital to the smaller concern as to the large one. What then can smaller companies look forward to in the way of a solution to their automation needs.

One answer to this need lies in a new mode of data processing which has made an appearance in recent months: the processing of punched paper tape by tabulating service bureaus.

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The Use of Punched Tape by Smaller Business

The application of punched tape to smaller business is based on the following premises:

1. The installation of computing or tabulating machines is not justified where the volume of transactions is too small to fully utilize machine capacity.

2. In order to get the benefit from the more efficient and fully automatic business machines, such as punched card equipment and commercial computers, the smaller company must join with others in pooling the use of these machines, that is, on a service bureau basis.

3. However, in order for this pooling to take place, there must be a convenient and economical way in which the information to be processed can be sent to the tabulating center and fed into the processing equipment automatically. Manual card punching and verification by service bureaus are too expensive.

4. The answer to this transmission problem is punched paper tape.

Punched paper tape has been used in the field of communications for many years. Its use as a data processing medium has been limited by (a) problems in connection with the machine which punches the tape (the input problem), and (b) the difficulty of finding service bureaus which have the ability to process the tape (the processing problem). Now it appears that the solution to both of these problems is at hand.

Solution to the Input Problem

Almost every sort of office equipment is now capable of being wired to a punching mechanism so that punched tape is automatically produced as the operator strikes the keys of the machine. A list of such office equipment would include typewriters, adding machines, comptometers, calculators, and bookkeeping machines. In the case of the more complex equipment a number of difficulties are encountered, such as the training of proficient operators, the difficulty of locating and correcting errors which have been punched into the tape, the additional cost of the punching mechanism, and the programming of the machine. And while the cost of tape input equipment is a great deal less than the cost of processing equipment, it is enough of a factor to make necessary the full-time use of the machine. In the case of smaller companies this means that the machines must be capable of performing several different jobs because no one job would use up the available time. In this regard, the more automated and complex machines are at a disadvantage since they are generally designed to perform one job, such as billing, posting or typing.

The Tape Adding Machine

The one type of input device which, for the most part, does not encounter these difficulties is the tape adding machine. This machine, as its name implies, is simply an ordinary adding machine to which has been added a tape punching mechanism. However, its primary function is not to add anything, but rather to enter numerical information into tape for further processing by tabulating machines. By the use of the non-add key, descriptive information such as invoice number, date, account number, etc., as well as dollar amounts can be entered into the tape. If the number of digits in the descriptive codes exceeds the capacity of the keyboard, any number of additional descriptive entries can be made, each with the use of the non-add key.

The secret of the success of the tape adding machine as an input device lies in the simplicity of its design. Because of its simplicity it requires very little skill to operate and a minimum of operator training. Also because of its simplicity there is a minimum of lost time due to breakdown (virtually none in our experience). Error correction generally requires no more than a simple reversing entry, similar to the correction of an adding machine tape. It can be manufactured at a cost which is substantially less than that of other input devices, and yet its product is more accurate and its function a great deal more flexible than that of the more automated tape input machines.

While there are now some six or seven manufacturers producing tape adding machines, a number of these have not yet been placed on the market. However, three makes of machines which have been in regular use for several years were tested by this writer and are described in the table on page 363.

As evidence of the variety of jobs which the tape adding machine can perform, this equipment is currently being used to produce sales analysis and other statistical reports, cost and production control, labor distribution, perpetual inventory, maintenance and aging of accounts receivable, complete general ledger bookkeeping, comparative financial statements, and income tax returns. A small company possessing just one of these machines can perform one or all of the above functions on the same tape adding machine, changing jobs at will without change of wiring, program bars, or the like.

While addition and subtraction are not the primary functions of the tape adding machine, its ability to provide subtotals and one, or in some cases two, grand totals is of major importance in controlling the accuracy of the tape. The importance of controlling accuracy in any data processing system cannot be overemphasized. Those errors made by the operator which are not located and corrected prior to the processing stage are compounded by the high speed of the processing equipment, at which point discrepancies become extremely costly to locate and very difficult to correct. The simplicity of the tape adding machine operation minimizes operator-error; and since the machine provides a visual adding machine tape together with control totals, the tape is virtually never out of balance. As an example of this, a general ledger posted on a tape adding machine can never fail to balance, because at the end of the run, a balance other than zero appearing in the adding machine register is an immediate indication of an improper posting. Similarly, if the ma-

TAPE ADDING MACHINES TESTED

	FRIDEN, INC.	NATIONAL CASH REGISTER CO.	MONROE CALCULATING MACHINE CO.
Keyboard type	ten key	full bank	full bank
Number of totaling registers	one	one	one or two
Safety mechanism	parity check	parity check answer-back circuitry	none
Reliability of punching mechanism	excellent	excellent	excellent
Technical training required to operate	none	none	none
Ability of non-technician to vary size of field	yes	no	yes, if so equipped
Ability to suppress insignificant zeroes	yes	yes	yes
Equipped with tape rewind	yes	yes	no
Location of punch mechanism	self-contained	separate box	self-contained
Price range excluding 6% federal excise tax	$2,250	$1,800 to $2,400	$1,500 to $1,800
Approximate monthly payment under two-year plan	$100	$75 - $100	$50 - $75
Over-all suitability for operation with service bureau	excellent	excellent	excellent

chine is being used to distribute a series of transactions where a continuous balance has been maintained, such as in the case of a checkbook, the ability to take a subtotal at any stage permits the operator to detect and correct errors easily. If the tape is error-free when it is sent to the service bureau, then the processing cost is much less than processing by manual punching and verification.

These many features of the tape adding machine make it one of the most practical and versatile input devices yet devised, and a most important factor in the development of data processing for the smaller business. It may well be the forerunner of a machine which does away with manual bookkeeping, much as the typewriter has done away with manual letter writing.

An Illustration of a Tape Adding Machine Application

One area in which many companies spend a great deal of clerical time is the analysis of sales into salesmen commission statements, sales tax and gross receipts tax reports, sales by department or product classification, sales by territory and customer, and sales figures for renegotiation reports, royalty payments and many other purposes. Where the company does not produce its invoices on punched card equipment it can nevertheless derive these reports from punched card equipment operated by service bureaus. It may deliver a copy of the invoice to the bureau, in which case the bureau will manually punch the information into cards; or it may produce punched tape or punched cards on its own premises, which tape or cards can then be processed by the service bureau at much reduced cost. In the area of punched tape there are the alternatives of using either a billing machine which produces punched tape as a by-product, or a tape adding machine. If a tape adding machine is used the tape would be created in the following manner:

1. The invoice is typed in a normal manner, except that certain numerical codes would be assigned to salesmen, territory, product classification, etc., depending upon what sort of information or report is desired. In many instances it would be practicable to insert a customer number in order to maintain accounts receivable records on punched cards, or a product number in order to maintain perpetual inventory records.

2. The invoice amounts are added in order to develop a proof total.

3. The designating codes, together with the dollar amounts are then entered on the tape adding machine, using the non-add key for designating information, and the plus or minus key for dollar amounts. For example, if a sale of Product No. 111 is made in the amount of $100.00 by salesman No. 22 to customer No. 3333, it might be entered on the adding machine as follows:

3333 22 111 *Non Add Key*
100.00 *Plus Bar*

Fixed or semi-fixed information can be "locked" into the adding machine and unlocked by simply replacing it with a new designating code number. For example, if Products Nos. 444 and 555 were also sold on the same invoice, only the new product numbers need be entered into the machine; the salesman number and the customer number are repeated automatically. If the tape adding machine is equipped with two registers, then individual items on the invoice can be added to arrive at the invoice total, while at the same time the invoice totals are being accumulated into a grand total. When this grand total is compared with the proof total

mentioned in step (2), there is virtually no chance of the various reports and accounts receivable ledger being out of balance. Experience has shown that 150 invoices containing an average of 5 items each can be entered on a tape adding machine in an hour or less. This replaces the time of arranging the invoices into proper order, adding each of the various classifications desired, locating errors and reconciling totals that fail to balance, and typing the final reports and statements.

4. The adding machine tape and punched tape are then placed into a manila envelope for mailing to the service bureau. Printed reports are returned by mail, in duplicate or triplicate if desired, within three to five days. Sample reports from entering sales invoice information might appear as in the illustration below.

ILLUSTRATIVE REPORTS BASED ON SALES INVOICE DATA

Style Clothes, Inc.

New York 3, N. Y.

SALESMAN ACTIVITY—OCTOBER, 1959

Territory: Upstate N. Y.
Salesman: Jack Knox

Customer	Product Code	Current Month Actual	Current Month Forecast	Year-to-Date Actual	Year-to-Date Forecast	Annual Potential
CHAPPELL C E	3	567	500	3489	3000	5000
CHAPPELL C E	4	0	250	0	1000	4000
CHAPPELL C E	7	1245	900	8473	7500	11000
		1812T	1650T	11962T	11500T	20000T
DEY BROS & CO	3	735	800	5873	6000	10000
ETC.						

COMMISSION STATEMENT—OCTOBER, 1959

Jack Knox	Current Month	Year-to-Date
FIVE PERCENT LINES		
CHAPPELL C E	1812	11962
DEY BROS & CO	2652	15932
EDWARDS E W	2219	16421
	6683T	44315T
SEVEN PERCENT LINES		
CHAPPELL C E	793	2362
ETC.		

PRODUCT SALES REPORT—OCTOBER, 1959

Product	Price Per Doz.	Current Month Units	Current Month Amount	Year-to-Date Units	Year-to-Date Amount
BLOUSES	38.50	253	9740	1293	49780
BLOUSES	42.50	212	9010	941	39992
BLOUSES	53.50	173	9255	844	45154
			28005		134926
SHIRTS	42.50	219	9308	1453	61752
ETC.					

While accuracy of the dollar amount is assured through proof totals, there is, as in any other bookkeeping system, the danger of putting the amount into the wrong account or category. However, this type of error can be minimized by proper design of the numerical codes. For example, if territory No. 3 is erroneously entered together with salesman No. 27, and salesman No. 27 works only in one or more other territories, the error shows up as an "illegal" entry and is earmarked on the report. In those circumstances where there is no such adequate means of avoiding unlocated errors in description, the visual adding machine tape can be sight-checked against the invoice. However, since the dollar amount is proven through the adding machine total, only the designating information need be checked for accuracy.

While the tape adding machine is limited to the entry of numerical information, the reports will nevertheless contain alphabetical descriptions, such as the name of the salesman or customer. The reader of the report need not work with a code chart, since the service bureau translates the code into an alphabetical description through the use of a master card.

If the operator discovers an error while entering the information on the machine, she can correct it either by reversing it or writing the correct number on the adding machine tape alongside the erroneous entry.

This illustration of sales analysis is only one example of the manner by which information can be sorted, distributed, totaled and typed in report form through the use of a tape adding machine in conjunction with a service bureau. The same advantages are gained when the machine is applied to the distribution of labor time and materials to arrive at cost and inventory figures, or the posting of general and subsidiary ledgers to produce financial statements, or wherever statistical information is needed. And the same tape adding machine can shift from one application to the other without adjustment of any sort.

Other Tape Input Machines

In many instances there is a sufficient volume of work to warrant the use of a more advanced type of tape input device to produce the data for processing by the service bureau. For example, there are now available a number of different machines designed for billing which produce, as a by-product, a punched tape for the purpose of deriving inventory control, sales analysis, commission statements and the other collateral reports. Some of these machines can enter alphabetical information as well as numerical. In addition, some of them have the ability to read as well as deliver punched tape or edge-punched cards, which eliminates a portion of the manual operation of the machine. These are features which the tape adding machine does not possess, so that where the application is suitable, and the volume of transactions is heavy enough to justify the full-time use of these more automated machines, they would be preferred over the tape adding machine.

However, a common misconception with regard to these more automated tape input devices is that the tape is a "free" by-product of the machine operation. This is not the case, since the addition of the tape punching mechanism adds many problems to the operation of the machine. Error correction becomes troublesome and generally requires costly manual comparison of the information contained in the tape with the source material. Then, too, the primary function of the machine, which,

for example, might be to type invoices, may be slowed for the sake of producing the by-product tape.

These practicalities of using the more complex type of input machines will in many instances favor the use of the less costly and more flexible tape adding machine.

Solution to the Service Bureau Problem

While the tape adding machine and the other tape producing office equipment provide the means of getting data into the proper form for low-cost automatic processing, there are at present only a handful of service bureaus which have the proper equipment and technical ability to process the tape. Since the use of tape producing machines has been small, there is little incentive for the independent service bureau to install tape converting equipment and, as a result, those who wish to use punched tape machines have encountered difficulty in finding a bureau to do the processing. Fortunately, an increasing number of independent service bureaus have recognized the application of tape as an economical means of servicing smaller companies, and are now operating tape converting equipment. As more public attention is drawn to the use of punched tape, the processing of tape by service bureaus will become commonplace. This writer has had occasion to survey most of the fifteen or twenty independent service bureaus in the metropolitan New York City area, and has learned that at least a third of these have the facilities for processing tape. A proportionate number of tape processing bureaus may exist in other parts of the country.

Despite the fact that the cost of manual card punching and verification is nearly twice as much as that of tape conversion, the processing of tape represents only a fraction of the work performed by service bureaus. The reason for this is not any inherent fault in punched tape as such, but rather in the improper choice of tape input machines and in ill-advised systems work. Frequently the persons responsible for setting up the tape input machine have too little knowledge of accounting principles, too little understanding of the company's needs and flow of paper work, and too little background in the operational requirements of the processing equipment.

Here again, however, simplicity is the answer. By using a simple device which has been manufactured to a fixed, standard program, the problem of programming the machine is eliminated, and the accountant can then set up a system without technical knowledge of either the input machine or the processing equipment. Such is the case with the tape adding machine which we operate in our accounting office. With a minimum of technical knowledge, we are able to design the proper system to suit the particular need of the client, without depending on detailed help from the machine company representative or the service bureau technician.

As an example of how the standard program has reduced service bureau charges, one of the bureaus now offers the tabulation of a complete set of books including journals, general ledger, and financial statement for as little as $10.00.

Other Solutions to Data Processing Needs

As an alternative to punched tape as a means of transmitting data to a service bureau, there are also means by which a smaller company can produce punched cards instead of punched tape, which cards can then be processed either by a service bureau or on their own low

rental series of punched-card equipment which the machine companies are now offering.

In order for a company to enter information into cards it must use a card-punch machine which is operated either as a separate unit or intercoupled to a bookkeeping machine or some other piece of office equipment. In the case of the separate card punch, the disadvantages include the necessity of hiring skilled key punch operators, the inability to list or prove the accuracy of the cards, the necessity of repunching the cards for verification, and the comparatively high cost of the card-punch machine. The handling and mailing of a large quantity of punched cards to a service bureau also presents a problem, in contrast to the ease of handling a roll of punched tape.

Where the card-punch machine is intercoupled to a bookkeeping machine, there are the advantages of having a visual record and, in some cases, a proof total of what has been punched into the cards, but these features are also contained in punched tape adding machines which are less costly and produce the same results.

With respect to a company doing the processing on its own slow-speed series of low rental tabulating equipment, there are a number of definite advantages over sending punched cards or punched tape to a service bureau. For example, there is no mailing delay, and certain jobs which cannot be handled by service bureaus, such as daily billing and updating of accounts receivable, can be processed on this equipment. However, it should be recognized that while the rental cost of these slow-speed tabulating machines is much less than the more versatile, high-speed machines, machine rental is only one of several costs of operating a punched-card installation. The cost of a supervisor, machine operators, space, cards, supplies, files, wiring panels and other materials is no less when slower speed equipment is used and, in fact, labor cost per card is higher.

It follows, then, that except in those situations where processing off premises is not feasible, a service bureau with its more experienced personnel, more flexible and efficient equipment, and ability to relieve the user of a fixed overhead burden, is probably the more suitable answer to the data processing needs of smaller companies. And since the trend in service bureaus appears to be in their acceptance of responsibility for the design and improvement of internal systems and procedures as well as the mechanical functions of data processing, the service bureau industry will take on an increasingly important role in this field.

Computers for Smaller Companies

In addition to the appearance of simplified tape input machines, there is another device on the horizon which has a significant tie-in with the use of punched tape, and also with the role of service bureaus. It is the development of the commercial or business electronic computer. While the term "computer" has many connotations, reference here is made to a machine which in effect contains anywhere between 1,000 and 10,000 adding machine registers in the form of magnetic storage locations within a magnetic drum, disc or core. The function of this type of computer is not to solve a complex mathematical problem as is the job of most present-day electronic computers. Its function, rather, is to receive a large volume of transactions, as, for example, department store sales, and sort these transactions into the proper classifications, accumulate totals for each classification, and deliver these totals into punched

tape which tape serves both as storage and as input to high-speed printing machines. Since this type of computer does not have to do much more than read punched tape, add, subtract, and read out totals, it is much less costly to produce and operate than present-day digital computers. For this reason it is economically feasible for a service bureau to utilize such equipment.

The applications of low-cost electronic computers would seem to have no limit. They are as much an advance over punched-card machines as punched cards are over manual record keeping. It is a commonly accepted rule in punched-card accounting that if only one report or type of information is needed, processing by punched cards is not economical. The reason for this is that punched-card processing entails a large amount of manual labor both to get information into the cards, and to program and operate the several pieces of tabulating equipment. However, by the use of an inexpensive machine which produces a tape, which tape is fed directly into a high-speed computer requiring very little manual labor to operate, it will then be economical to process information even though only one report or analysis is sought. This will have great impact on data processing for the smaller company which lacks the time and personnel to evaluate collateral reports and is interested only in basic information.

While at present there are no business computers of this type available, a number of these machines are in the development stage, and will make their appearance in months to come. Business concerns which now gain experience in the use of punched paper tape will later find it a simple transition to processing of the tape by computers.

In Summary

Heretofore the use of punched tape by smaller companies has not been widespread primarily because of the reluctance on the part of service bureaus to process tape and because of the cost and difficulties encountered in the use of the more automated types of punched tape devices. In answer to the first problem, service bureaus have already started to recognize the advantages of processing tape as opposed to the manual key punching and verification of raw data. The answer to the second problem lies in the use of a simple, inexpensive input device which can be used by unskilled operators to perform many different jobs. The tape adding machine is such an instrument.

In years to come, the cost of the input device will be reduced still further by advances in the development of magnetic and photoelectric materials, and at the same time the cost of processing will be reduced by the development of the business computer. With such advances it is not hard to visualize the adoption of mechanized record keeping by even the smallest of business offices.

New York State Tax Forum

Guest Editor—Nathan Eidenberg, CPA

Some Aspects of the New Personal Income Tax Changes

Fiscal Year Taxpayers

In the case of such taxpayers, the forgiveness feature applies to fiscal years ending in 1959. Thus the tax is forgiven on the income (except capital gains) for fiscal years beginning in 1958 and ending as late as November 30, 1959. If such a taxpayer's year ends after March 31, 1959, and if he has income from wages, the question arises whether the employer is required to withhold on wages paid on or after April 1, 1959 and within such fiscal year. The answer seems to be that withholding is not required since Section 366 provides that "on and after April 1, 1959, every employer making payment of any wages *taxable under this article* shall deduct and withhold . . ."

As to the filing of declarations of estimated tax in the case of fiscal year taxpayers, the statute provides little guidance since its provisions are geared to calendar year taxpayers. The gap will probably be filled by special rulings or regulations.

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Withholding Tax on Wages Paid to New York Residents Employed in Other States

This question has become rather acute in the case of New York employers who have employees, residents of New York, who work at locations in New Jersey. That State has held that under its laws such withholding is illegal. In the light of this situation, the State Tax Commission has just ruled that "for the present" to avoid imposing a duty on employers which may constitute a violation of the law of another state, employers of New York residents who perform services in such states will not be required to withhold taxes from wages of such employees. The Commission points out, however, that where a New York resident performs services both within and without New York the employer is required to withhold taxes on wages. Where a non-resident performs services in New York, his wages are subject to withholding despite the provisions of the law of the state of his residence.

Declarations and Payment of Estimated Tax Where Entire Income is From Wages Subject to Withholding

Section 366-a, subdivision 1 of the Tax Law requires the filing of declara-

Ed. Note: For an interim period, until a permanent departmental editor has been selected, this department will be conducted by guest contributors.

tions of estimated tax if the combined gross income and net capital gain can reasonably be expected to exceed $5,000 in the case of a single taxpayer, or $10,000 in the case of a married couple entitled to file a joint declaration.

However, subdivision 3 of Section 366-a authorizes the State Tax Commission to permit the filing of such declarations on or before January 15th of the succeeding taxable year in cases where the total estimated tax is $40 or less. (Declarations of estimated tax reflect the excess of the estimated tax over the tax expected to be withheld.)

The Tax Commission has recently exercised this discretionary authority by ruling that no declaration will be required until January 15th of the succeeding taxable year where the estimated tax for the year is $40 or less. The ruling states that where the taxpayer's income for 1959 is principally from wages subject to withholding so that the amount of tax in excess of the amount expected to be withheld is $40 or less, no declaration is required to be filed until January 15, 1960, at which time the entire tax must be paid. The ruling goes on to say that in lieu of filing a declaration on such date the taxpayer may elect to file his final return for the year 1959 and pay his entire tax on or before January 31, 1960. It is pointed out that the filing of a declaration and payment of the estimated tax on January 15th of the succeeding year, or the filing of a final return and payment of the tax on January 31st of the succeeding year, will not relieve the taxpayer of penalties if a declaration or payment of estimated tax was required prior to such dates.

High Incidence of Overpayments

Since state income taxes are deductible for federal income tax purposes by taxpayers who itemize deductions on their federal income tax returns, the high incidence of overpayments of New York State income taxes through withholding and declarations may raise some questions. Heretofore payments of New York State income taxes were made in discharge of an actual tax liability and were deductible as such. Under Section 366 of the present Tax Law, employers are required to withhold from wages a "tax computed in such manner as to result, so far as practicable, . . . in withholding from the employee's wages during each calendar year, a sum which is substantially equivalent to the amount of tax reasonably estimated to be due under this article resulting from the inclusion in the gross income of the employee of his wages received during such calendar year."

Section 366-a of the Tax Law also provides, in appropriate circumstances, for the filing of declarations and payment of estimated taxes during the taxable year.

In view of the probability that taxes withheld and paid through declarations will exceed the tax liability in many instances, the question arises whether taxpayers will be permitted to deduct the amounts withheld and/or paid during the year, or whether the deduction will be limited to the smaller actual tax liability. It would seem that since the amounts withheld on wages or paid with declarations are withheld or paid as taxes, albeit estimates, the amounts so withheld or paid should be deductible as taxes in the taxable year during which the withholdings or payments were made. This conclusion is buttressed by Section 374 of the Tax Law which provides for the refund of *taxes* overpaid through withholding or declarations.

Accounting at the SEC

Conducted by Louis H. Rappaport, CPA

Activities of the Commission in Accounting and Auditing

As Reported in its Twenty-Fourth Annual Report

The SEC recently issued its annual report to Congress covering the fiscal year ended June 30, 1958. As usual, the report contains a section dealing with the Commission's activities in accounting and auditing. This section of the report makes interesting reading for CPAs because it summarizes concisely the SEC's activities and objectives in the areas of accounting and auditing. An excerpt from the report is reprinted below.

Successive reports of the Commission have called attention to the fact that the detailed provisions of the several acts administered by the Commission recognize the importance of dependable informative financial statements which disclose the financial status and earnings history of a corporation or other commercial entity. These statements, whether filed in compliance with the statutes administered by the Commission or included in other material available to stockholders or prospective investors, are indispensable to investors as a basis for investment decisions.

The Congress recognized the importance of these statements and that they lend themselves readily to misleading inferences or even deception, whether or not intended. It accordingly dealt extensively in the several statutes administered by the Commission with financial statement presentation and the disclosure requirements necessary to set forth fairly the financial condition of the company. Thus, for example, the Securities Act requires the inclusion in the prospectus of balance sheets and profit and loss statements "in such form as the Commission shall prescribe"[17] and authorizes the Commission to prescribe the "items or details to be shown in the balance sheet and earnings statement, and the methods to be followed in the preparation of accounts * * *."[18] Similar authority is contained in the Securities Exchange Act,[19] and more comprehensive power is embodied in the Investment Company Act[20] and the Holding Company Act.[21]

The Securities Act provides that the financial statements required to be made

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available to the public through filing with the Commission shall be certified by "an independent public or certified accountant." [22] The other three statutes permit the Commission to require that such statements be accompanied by a certificate of an independent public accountant,[23] and the Commission's rules require, with minor exceptions, that they be so certified. The value of certification by qualified accountants has been conceded for many years, but the requirement as to independence, long recognized and adhered to by some individual accountants, was for the first time authoritatively and explicitly introduced into law in 1933. Out of this initial provision in the Securities Act and the rules promulgated by the Commission,[24] and the action taken by the Commission in certain cases,[25] have grown concepts of accountant-client relationships that have strengthened the protection given to investors.

The Commission's standards of independence are stated in rule 2-01, paragraphs (b) and (c), of Regulation S-X which provides among other things that "an accountant will be considered not independent with respect to any person or any of its parents or subsidiaries in whom he has, or had during the period of report, any direct financial interest or any material indirect financial interest; or with whom he is, or was during such period, connected as a promoter, underwriter, voting trustee, director, officer or employee."[26] In determining whether an accountant may in fact be not independent with respect to a particular person, the Commission will give appropriate consideration to all relevant circumstances, including evidence bearing on all relationships between the accountant and that person or any affiliate thereof.

In the recent revision of this rule the Commission has recognized the impact of mergers and the growth of corporations through widespread affiliations. The emphasis in the rule has been changed to make it clear that where the relationships described in the rule exist the Commission will find that an accountant is in fact not independent with respect to the company involved, but in those instances where lack of independence is not established the Commission will make no finding with respect to the accountant's independence.

Several situations, described in the 22nd and 23rd Annual Reports, in which accountants were not eligible under our rules to certify financial statements because they were lacking in independence continue to cause difficulty. In many of these instances the accountants and their clients were coming in contact with the Commission's filing requirements for the first time and the reason for the lack of independence was ownership by a member of the accounting firm of stock of the client company during some of the periods certified. In other cases the accountant or his firm may have been interested in serving the client's management, or in some cases large stockholders, in several capacities and in doing so had not taken care to maintain a clear distinction between giving advice to management and serving as personal representatives of management or owners in making business decisions for them. Many of these problems could be avoided if the accountants would look forward to the day when the public interest in their clients would require certification of financial statements by independent public accountants.

As shown above, the statutes administered by the Commission give it broad rule-making power with respect to the preparation and presentation of financial statements. Pursuant to authority contained in the statutes the Commission has prescribed uniform systems of ac-

counts for companies subject to the Holding Company Act; [27] has adopted rules under the Securities Exchange Act governing accounting and auditing of securities brokers and dealers; and has promulgated rules contained in a single, comprehensive regulation, identified as Regulation S-X, [28] which govern the form and content of financial statements filed in compliance with the several acts. This regulation is implemented by the Commission's Accounting Series releases, of which 80 have so far been issued. These releases were inaugurated in 1937, and were designed as a program for making public, from time to time, opinions and accounting principles, for the purpose of contributing to the development of uniform standards and practice in major accounting questions. The rules and regulations thus established, except for the uniform systems of accounts, prescribe accounting to be followed only in certain basic respects. In the large area not covered by such rules, the Commission's principal reliance for the protection of investors is on the determination and application of accounting principles and auditing standards which are recognized as sound and which have attained general acceptance.

Since changes and new developments in financial and economic conditions affect the operations and financial status of the several thousand commercial and industrial companies required to file statements with the Commission, accounting and auditing procedures cannot remain static and continue to serve well a dynamic economy. It is necessary for the Commission to be informed of the changes and new developments in these fields and to make certain that the effects thereof are properly reported to investors. The Commission's accounting staff, therefore, engages in studies of the changes and new developments for the purpose of establishing and maintaining appropriate accounting and auditing policies, procedures and practices for the protection of investors. The primary responsibility for this program rests with the chief accountant of the Commission who has general supervision with respect to accounting and auditing policies and their application.

Progress in these activities requires constant contact and cooperation between the staff and accountants both individually and through such representative groups as, among others, the American Accounting Association, the American Institute of Certified Public Accountants, the American Petroleum Institute, the Controllers Institute of America, the National Association of Railroad and Utilities Commissioners, the National Federation of Financial Analysts Societies, as well as other government agencies. Recognizing the importance of cooperation in the formulation of accounting principles and practices, adequate disclosure and auditing procedures which will best serve the interests of investors, the American Institute of Certified Public Accountants, the Controllers Institute of America, and the National Federation of Financial Analysts Societies regularly appoint committees which maintain liaison with the Commission's staff.

The many daily decisions of the Commission require the almost constant attention of some of the chief accountant's staff. These include questions raised by each of the operating divisions of the Commission, the regional offices and the Commission. This day-to-day activity of the Commission and the need to keep abreast of current accounting problems cause the chief accountant's staff to spend much time in the examination and re-examination of sound and generally accepted accounting and auditing principles and practices. From time to time

members of this staff are called upon to assist in field investigations, to participate in hearings and to review opinions, insofar as they pertain to accounting matters.

Prefiling and other conferences, in person or by telephone, with officials of corporations, practicing accountants and others, occupy a considerable amount of the available time of the staff. This procedure, which has proven to be one of the most important functions of the office of the chief accountant, and of the chief accountant of the Division of Corporation Finance and his staff, saves registrants and their representatives both time and expense.

Many specific accounting and auditing problems arise as a result of the examination of financial statements required to be filed with the Commission. Where examination reveals that the rules and regulations of the Commission have not been complied with or that applicable generally accepted accounting principles have not been adhered to, the examining division usually notifies the registrant by an informal letter of comment. These letters of comment and the correspondence or conferences that follow continue to be a most convenient and satisfactory method of effecting corrections and improvements in financial statements, both to registrants and to the Commission's staff. Where particularly difficult or novel questions arise which cannot be settled by the accounting staff of the divisions and by the chief accountant, they are referred to the Commission for consideration and decision. By these administrative procedures the Commission deals with many accounting questions.

Inquiries in ever-increasing volume as to the propriety of particular accounting practices come from accountants and from companies not presently subject to any of the acts administered by the Commission who wish to have the benefit of the Commission's views and thus utilize and apply the Commission's experience to the facts of their own case. Teachers of accounting and their students also use the public files and confer with the staff in the study of accounting problems.

Cooperation between the Commission and professional groups interested in improving financial reporting has been mentioned. An example is the publication in April, 1958, by the Committee on Accounting Procedure of the American Institute of Certified Public Accountants of its Accounting Research Bulletin No. 49 dealing with a number of the problems arising in connection with the computation of earnings per share and the presentation of such statistics in prospectuses, proxy material and annual reports to shareholders and in the compilation of business earnings statistics for the press, statistical services and other publications.

Appropriate determination of earnings per share has been a frequent subject for comment by the staff in connection with filings with the Commission. A decrease in improper presentations since publication of the bulletin may fairly be credited in part to the wide distribution of the bulletin. Such literature contributes to greater uniformity in financial reporting, improves investor understanding, and decreases staff time spent in processing material filed with the Commission.

A further example of the importance of cooperation between the staff and professional accounting organizations is found in the Commission's authorization for its chief accountant to serve as a member of the American Institute of Certified Public Accountants' Special Committee on Research Program. This committee, the other members of which are leaders of the accounting profession

in public and private practice and in teaching, was appointed to consider a new approach to accounting research. Since investors in securities depend upon the results of the accounting process, it is appropriate that the Commission be represented in this endeavor to find a better means for the development of generally accepted accounting principles which serve as a guide for independent accountants practicing before the Commission.

Some significant characteristics of the past year in the accounting field may be mentioned. As in the prior two years, accounting for mergers has again required much staff time in conferences with registrants and their accountants. Usually the problem has been to determine the propriety of applying the pooling of interests concept which avoids the booking of goodwill by using the accounting basis of the constituent companies and permits the carrying forward of the earned surplus of the parties to the merger.

In contrast to this desire of established companies to avoid the recognition of intangibles is the insistence by promoters of new ventures to place excessive valuations on the books for both tangible and intangible properties. Examples during the past year have been reminiscent of the early days of the Commission when it was found necessary to deal vigorously with promotional ventures in which shares of the issuer's stock were exchanged for assets of doubtful value but were recorded at the par value of the shares issued. For an example of this kind see the discussion of the Commission's decision *In the Matter of the Fall River Power Company*[29] at page 39 of this report.

Another characteristic of the past year has been the number of cases coming to the attention of our accountants in which a change in accounting policy has been adopted or desired. Where a change has appeared to be motivated by a desire to improve current earnings by deferring the expensing of incurred costs, we have objected unless it could be shown that the new method was clearly in the interest of improved financial reporting in the long run. Accounting for research and development costs for new products or expansion into new sales territories are examples of this problem which require further study.

Of a somewhat different order but a problem requiring further study is the matter of accounting for pensions and other forms of deferred compensation. There are so many difficulties in the way of determining the amounts involved and the proper allocation of such costs to accounting periods that a considerable lack of uniformity in accounting treatment persists between companies and between periods in the same company. Improvement in reported earnings resulting from omission of any charge for pensions is an extreme example of the problem which seems to be vulnerable to severe criticisms but which has been defended when pensions have been overfunded in prior years. These and other problems in the reporting of corporate income are receiving active consideration by the accounting profession and by the Commission's accounting staff.

References

NOTE: Footnotes 1 to 16 relate to other sections of the Commission's Report.

17. Section 10(a)(1) (Schedule A, pars. 25, 26).
18. Section 19(a).
19. Section 13(b).
20. Sections 30, 31.
21. Sections 14, 15.
22. Section 10(a)(1) (Schedule A, paragraphs 25, 26).
23. Securities Exchange Act, Section 13(a)(2); Investment Company Act, Section 30(e); Holding Company Act, Section 14.

24. See, for example, rule 2-01 of Regulation S-X.
25. See, for example, Securities Exchange Act Release No. 3073 (1941); 10 S. E. C. 982 (1942); and Accounting Series Release No. 68 (1949).
26. Rule 2-01 of Regulation S-X as amended April 8, 1958. See Accounting Series Release No. 79.
27. *Uniform System of Accounts for Mutual Service Companies and Subsidiary Service Companies* (effective August 1, 1936); *Uniform System of Accounts for Public Utility Holding Companies* (effective January 1, 1937; amended effective January 1, 1943).
28. Adopted February 21, 1940 (Accounting Series Release No. 12); revised December 20, 1950 (Accounting Series Release No. 70).
29. Securities Act Release No. 3932 (June 4, 1958).

Inflation and Financial Statements

The accountant should look behind dollar figures and attempt to determine if the company is doing any more than just receiving its share of the inflationary bite. The real danger of inflation is that it comes in small doses. Every year is "immaterial", but the total dose is staggering. A useful report that each accountant should seriously consider preparing for management purposes is an annual statement disclosing the effect of inflation on company earnings and shareholders' investments. A trend statement for five or ten years showing how the company progressed before and after consideration of inflation would also be valuable. By bringing the effect of inflation forceably home to management, there may be disclosure of important problems previously overlooked. . . .

The challenge to the accountant is to really get the facts and figures on inflation, to apply them item by item to every important facet of the business, to appraise this information first, and then pass it on to management. The results of a study such as this will be very profitable to the accountant as well as to the company, and may be eye-opening in areas of the business which need attention and thought.

ALBERT J. BOWS, JR., "Creative Accounting Pays Its Way," THE ARTHUR ANDERSEN CHRONICLE, April 1959

Administration of a CPA Practice

A forum for the exchange of views and information on all aspects of the administration of an accounting practice.

Conducted by MAX BLOCK, CPA

Protecting Clients from Tax Penalty

The Code does not permit the deduction of certain ordinary expense accruals involving "related persons," as specially defined, unless payments are made within 2½ months after the close of the creditor-taxpayer's fiscal year. An oversight of this arbitrary rule can be very costly to the taxpayer, and possibly to the accountant, as he may be accused of not bringing this technicality to the attention of the taxpayer.

This hazard can be protected against by the use of a form letter advising the taxpayer of this rule and listing, in tabulated form, the items payable and the terminal date. The expenses to be paid could be placed under three column headings, to wit: payee, expense, and amount.

The form, to be prepared in duplicate, should be completed at the earliest of these events: the preparation of the adjusting entries, the preparation of the annual report, or the preparation of the tax return, as is practical in the individual case. Some accruals may be of large amount; therefore the client should be given early notice to facilitate the financing. Where cash or time is a problem, notes or other forms of payment can be used.

Report and tax return reviewers should be concerned about the reporting of this data, its completeness and correctness. The office copy of the form letter should carry the name of the preparer and provide space for the initials of the reviewer. Control over the timely mailing of such forms is necessary to insure against oversight and a checklist of closings, by terminal dates, could be used for this purpose.

Efficiency is True Economy

Accountants, as employers and as advisors to managements, should find a valuable bit of advice in the following excerpt from "Bankers Bulletin," a house organ of Bankers Commercial Corporation:

"In these days when every business expense should be carefully scrutinized and all needless outlays prevented, it's important to remember that the only real expense control is the promotion of utmost efficiency.

MAX BLOCK, CPA *(N. Y., Pa.), is a former chairman of the Committee on Administration of Accountant's Practice of the New York State Society of Certified Public Accountants. He is a lecturer at the Baruch School of Business and Public Administration of The City College of New York in the graduate course on Accounting Practice. Mr. Block is a member of the firm of Anchin, Block & Anchin.*

"To lay off a man and save some thousands of dollars a year is nothing like so thrifty as to develop that man into a producer worth several times what he formerly was paid. Sometimes that isn't possible, of course. But keeping that man on the job and earning greater profits from his work is not only highly advantageous to the employer but a policy that benefits society.

"The way to prevent depression is to provide employment for as many producers as can be developed. Every cut in the payroll sets up an economic roadblock. The more employes that can be kept at work by stepping up their productivity the greater the value of your business to the nation and the world."

Staff Evaluation

The Chairman of our Society's Committee on Administration of Accountants Practice, Kenneth B. Wackman, CPA, recently presented a paper at a Graduate Study Conference at New York University dealing with certain aspects of administration. One of them was that of staff evaluation. He discussed the use of two types of evaluation reports. The first, prepared at the end of an engagement (annual audit) by the senior in charge of the audit, evaluates the work of his assistants. Each man is rated. The assignment is described and the men classified so that the ratings may be reconciled with the staff men's accounting experience and the nature of the job. This form is here reproduced as Exhibit I. The second report is prepared by each staff accountant on the engagement and is designed to determine the amount of understanding he has applied to the engagement. This form is here reproduced as Exhibit II.

Other evaluation report forms will be found in the CPA HANDBOOK (Chapter 9) and in Rockey's ACCOUNTANT'S OFFICE MANUAL (pp. 133-134).

Exhibit I

EVALUATION REPORT

Rated as: .... (Junior, Semi-Senior, Senior, Supervisor)

Date ....

Name ....

Rated by ....

Brief description of assignment (indicating name of company) upon which this evaluation is based:

....

....

....

If rating on any qualification is fair or poor, support your rating with specific examples in comment column.

EVALUATION REPORT (Continued)

	(Indicate by ✔)				
	Excellent	Good	Fair	Poor	Comments
A. AUDITING ABILITY					
1. *Working Papers*					
a. Completeness					
b. Conciseness					
c. Neatness					
d. Clearness					
e. Adequacy of cross referencing					
f. Indexing					
2. *Technical Ability*					
a. Appliance of accounting and auditing theory					
b. Knowledge of accounting and auditing theory					
c. Inquiry into accounting systems, internal control, etc.					
d. Preparation of financial statements and schedules					
e. Preparation of reports					
f. Perception of assignments, accounting and auditing problems					
3. *Application to Work*					
a. Conscientiousness					
b. Carefulness					
c. Imagination					
d. Speed of performance					
e. Time consciousness					
f. Enthusiasm					
4. *Sense of Responsibility*					
a. Carrying out instructions					
b. Self-reliance					
c. Constructive mindedness					
B. PROFESSIONAL QUALIFICATIONS					
1. Relations with clients					
2. Relation with other staff men					
3. Professional interests					
4. Ability to speak					
5. Ability to write					
C. PERSONAL QUALIFICATIONS					
1. General personality					
2. Appearance					
3. Respect for superiors					

EVALUATION REPORT (Continued)

	(Indicate by ✔) Excellent	Good	Fair	Poor	Comments
4. Moral character					
5. Outside interests					
6. Qualities of leadership					
7. Tact					
8. Ambition					
9. Reasoning ability					
10. Perseverance					
11. Diligence					
12. Punctualness					
13. Willingness to work overtime if necessary					
14. Willingness to travel when necessary					
15. Sense of humor					

OVERALL RATING ....
(Excellent, Good, Fair, Poor)

Exhibit II

STAFF ACCOUNTANT'S REPORT ON ASSIGNMENT

A good staff accountant must have more than a knowledge of subject matter. He needs (a) ability to "follow through," (b) ability to transmit to supervisor the unusual points arising in an engagement, (c) initiative to check with supervisor the firm policy with regard to nonroutine matters, and (d) ability to write concisely and clearly. To assist in development of these abilities and to promote a well-rounded knowledge of subject matter, each staff member shall UPON COMPLETION of an assignment, submit this report including all data which may be applicable.

STAFF MEMBER .... CLIENT ....

NATURE OF BUSINESS .... TYPE OF ASSIGNMENT ....

DATE STARTED AND COMPLETED .... WORKED UNDER SUPERVISION OF ....

PARTNER .... SUPERVISOR ....

DESCRIBE BRIEFLY PHASES OF WORK PERFORMED BY YOU ....

....

....

....

....

STAFF ACCOUNTANT'S REPORT ON ASSIGNMENT (Continued)

SUMMARIZE NEW EXPERIENCES
ON PROCEDURES LEARNED ....

....

....

....

....

STATE YOUR OPINION ON FOLLOWING MATTERS: (Use attached sheet)

1. To what extent did client deviate from generally accepted accounting principles? Why was such deviation important or unimportant in this assignment?
2. Internal control: What are the strong points and the weak points? How could weakness be strengthened? How could defalcation occur?
3. Audit program: What portion of program performed by you appears unsatisfactory either because it actually fails to verify or because time required is excessive for objective? What changes in program would you recommend?
4. Other suggestions or comments.

Depreciation and Inflation

What the victims of the present narrow, restrictive and discriminatory depreciation methods want is a chance to do their full duty to the country and its economy. They want to be able to provide the tools that will provide the jobs for those who are still unemployed. They want to produce, to develop, to help bring this country back to equality with its foreign competitors and to strengthen its economy and its potentialities for the good life and for its defense.

This cannot be done unless we recognize that the old days, the old methods, the old ideas are gone forever. Many of us were alive when the gold standard was in effect throughout the civilized world, when stability was the rule, not the exception, when prices responded quickly and sensitively to the opinion of the market place and when government intervention in business and economic affairs was almost unheard of.

For good or evil those days are gone and will not come again. Yet our tax laws and our depreciation policies, developed when those conditions prevailed, have never changed basically.

MAURICE E. PELOUBET, "Insufficient Depreciation and Inflation," THE CONTROLLER, March 1959

Payroll Tax Notes

Conducted by Samuel S. Ress

Unemployment Insurance Legislation Passed in 1959

Eight measures were passed by the New York State Legislature to amend the Unemployment Insurance Law this year. The bills affect benefit claimants and the rights and obligations of employers under the law with reference to coverage, merit rating, request reporting penalties and the right to make voluntary contributions to the unemployment insurance fund so as to obtain the benefit of a lower experience rate than might have otherwise been possible. This last measure has some interesting possibilities for accountants and employers interested in effecting unemployment insurance tax savings through proper tax planning.

1. *Coverage of One or More Employees.* This measure amends Section 560 and extends coverage to any employer paying remuneration of $300 or more in any calendar quarter, without regard to the number of employees. Coverage commences with the quarter immediately following the quarter in which remuneration of $300 or more is paid. Domestic workers continue to be considered separately. Since 1956, employers of 2 or more persons on any one day are required to be covered except in the case of domestic employees. Domestic workers are covered following any day starting with a day on which four or more domestic employees are covered. (Effective January 1, 1960.)

2. *Employer's Request Reporting Penalty.* This measure amends Section 575.2 and provides that the $10 penalty on an employer for failure to supply wage and employment information on form LO-12 within 7 days from the date of mailing the request to the employer, shall not be imposed when failure is attributable to "good cause" instead of to "circumstances beyond his control" as was provided heretofore. The passage of this measure is the first bit of relief given to employers and accountants who have heretofore been plagued by these $10 penalties despite the existence of good cause for the delinquency. For all practical purposes "circumstances beyond the control of the employer" had been limited to destruction of records by fire, or because of death.

3. *Apportionment of Vacation Pay for Experience Rating.* Apportionment

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Dr. Ress is a member of the Society's Committee on New York State Taxation and chairman of its Subcommittee on Unemployment Insurance.

of advance vacation payments is permitted to the proper calendar quarter for experience rating purposes so as to avoid a showing of a "quarterly decrease quotient" greater than would otherwise have occurred. Accountants should bear this amendment in mind in connection with "experience rating" tax planning. (Effective April 1, 1959.)

4. *Employer's Voluntary Contributions.* This measure permits an employer to voluntarily make payments to his account in excess of required payments. The effect of a possible small voluntary tax payment may give him the benefit of a more favorable experience rating balance in his employer account. (Effective July 1, 1959.)

5. *Extension of Time to Appeal Claim Determination.* This enactment extends from 20 to 30 days the time within which the claimant, the employer or the Industrial Commissioner may appeal from a decision or determination involving a benefit claim for a hearing before a referee. (Effective April 1, 1959.)

6. *Recovery of Overpayments.* This amendment permits claimants in all cases instead of only in original claims to retain benefits paid in error and received by claimant in good faith and without fraud or misrepresentation. Under such circumstances, where benefits have been paid and charged against an employer's account despite his timely protest, it would appear that the employer would have the right to have such benefit payment charges eliminated from the employer's account without the possible bad employer-employee relationship that might otherwise result. (Effective March 24, 1959.)

7. *Temporary Emergency Benefits Reimbursement to U. S.* This provides for repayment to the federal government of advances received under the Temporary Unemployment Compensation Act which permitted payment of benefits for a maximum 39-week period instead of 26 weeks. Employers' accounts were not originally charged for these temporary extended benefits and the experience rate assigned to employers this year did not reflect these charges. Under this measure the temporary benefit payments that had not been previously charged against employers' accounts will be charged during the coming year for the amounts of temporary benefits paid and not charged last year.

8. *Temporary Emergency Benefits Extension.* The extra 13 weeks of benefits provided by the federal emergency legislation enacted last year expired originally on April 5, 1959 and was recently extended to July 5, 1959. The New York State Legislature in conformity with the Federal enactment enables a claimant already qualified before April 6, 1959 for at least one temporary unemployment compensation payment to receive a maximum of 13 payments, provided that his benefit year is still running. A benefit year is the 52-week period after a claimant files a valid original benefit claim under the regular state program. Claimants whose benefit years have expired are not entitled to the 13 weeks temporary additional benefits provided by this measure. On the start of a new benefit year after the filing of a new valid original benefit claim the maximum benefit period during the new benefit year reverts to 26 weeks.

Federal Income Taxation

Decisions and Rulings — RICHARD S. HELSTEIN, CPA

Commentary — Committee on Federal Taxation
Chairman, HERBERT M. MANDELL, CPA

Decisions and Rulings

Practice Before the Internal Revenue Service

There has been added to the Regulations on Practice Before the Internal Revenue Service, Section 10.7(a) (7) permitting representation of a taxpayer at the examination level by one who prepared the return, even though such person is not enrolled to practice before the Treasury Department. (These proposed provisions were discussed in the January and February 1959 issues of the NYCPA.)

The provisions for such representation provide, inter alia, that the preparer of a return can appear with or without the taxpayer when he is "duly authorized" by the taxpayer. He may represent the taxpayer before the Field or Office Audit divisions in the District Director's office. He may not represent the taxpayer at an "informal conference" in the District Director's office, nor before the Appellate Division or the National Office in Washington, D. C. His representation is limited to income, excise or employment tax returns. He may not represent the taxpayer with respect to estate or gift tax returns, or income and excess profits tax returns of corporations. However, if a person prepared both the corporation return and the individual returns of any of the corporate officers for a particular taxable year, and is appearing as a representative of the corporate officer, he may also appear as the corporation's representative.

An individual can only deal with the taxable year for which he prepared the return. Thus, where net operating losses are involved, he cannot deal with the prior or subsequent years to which such net operating losses are carried, unless he prepared the returns for such years. Moreover, he cannot execute claims for refund for the taxpayer; he cannot receive refund checks for the taxpayer; he cannot execute waivers of the statute of limitations for the taxpayer; he cannot execute closing agreements, waiver forms 870 or similar agreements for the taxpayer; he cannot receive correspondence addressed to the taxpayer; he cannot receive form L-19 nor a 30-day letter on behalf of the taxpayer (all protests and informal conferences must be arranged through enrolled persons); he will be expected to call in an enrolled attorney or agent when complications arise.

In order to represent the taxpayer, the "preparer" must file an authorization and a fee statement with the Director's office. The suggested forms appear in Rev. Proc. 59-3 (IRB 1959-7, 29) adopting Section 10.7(a)(7) of Circular 230.

It is further provided in Rev. Proc. 59-4 (IRB 1959, 39) that any individual who has knowledge of facts, or who can be of assistance in establishing facts, but who did not prepare the return, or did not otherwise qualify for representation as described above, may appear and be heard on behalf of the taxpayer in the capacity of a "witness." In such capacity he may only testify as to facts, and cannot act as an advocate.

A New Development in Net Worth Cases

In tax evasion cases, the Government's task of determining the amount of unreported income was almost impossible to achieve without cooperation of the taxpayer. Although the Commissioner's determination is presumed correct (except on the question of fraud itself), it cannot be arbitrary or capricious. Because of the difficulties inherent in the independent reconstruction of income of a recalcitrant taxpayer by the Government, the courts have accepted the "net worth method" despite its weaknesses, and have presumed the computation under this method to be correct. Thus, where the Government, in civil fraud cases, has asserted a certain amount of unreported income, computed under the "net worth method", it has not been sufficient heretofore that the taxpayer show errors in the Government's computations; in effect, the taxpayer has had to establish the correct amount of unreported income—even if it be zero. This burden was almost as difficult as the Government's original problem of reconstruction, and resulted in many inequities.

The Sixth Circuit Court of Appeals has attempted to rectify the situation by ruling that where a taxpayer can show any errors in the Government's computation which affects the final determination, the burden of proof then falls upon the Government to support the over-all determination. In this case, the Government asserted unreported income, the determination of which was computed through the net worth method. The taxpayer demonstrated that the Government made two substantial errors: it omitted an item from the opening net worth statement, and it included an item in the closing net worth statement which had been disposed of by the taxpayer prior thereto. The Court held that in view of the errors, the determination of additional income could not be correct, and that it was not the onus of the taxpayer to establish what the correct amount was, but that the burden of proof passed to the Government. (*Vernon Harp et al* v. *Com.*, CA-6, 2/11/59.)

Whether this is a solution of the problem, remains to be seen. Certainly it will force the Government to be more conservative in its computations and possibly it will cause the Government to be more receptive in conferences prior to trial.

Filing of Consolidated Returns

The following release (TIR-143) is set forth verbatim:

The time for filing the return for a taxable year ending on or after December 31, 1958, but before June 30, 1959, by a corporation which is a member of an affiliated group having the privilege of making a consolidated

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return for such taxable year has been extended to September 15, 1959.

Requests for an additional extension of time for filing such return beyond that set forth in the preceding paragraph to which the taxpayer may be entitled under Section 6081(a) or (b) should be addressed to the District Director of the Internal Revenue District in which the consolidated return will be filed.

This extension of time shall not be construed as an extension of time for payment of tax nor as a waiver of liability for interest on any amount of tax due and unpaid as provided by law.

State Tax Penalties as Deductions

It has long been a policy to disallow penalties as deductions on the grounds that to allow them would mitigate the degree of punishment inflicted by the State upon those who commit acts violative of public policy. However, based upon a qualification of the Supreme Court in its opinion in *Tank Truck Rentals, Inc.* v. *Commissioner* (1958, 356 U. S. 30), the 3rd Circuit Court of Appeals has held in a recent case that the test of the deductibility of State tax penalties should hinge on the purpose and severity of the violation of public policy for which it is inflicted. Thus, where payment of a state tax is deliberately withheld in order to test the applicability of that particular tax, there was no intent to violate public policy and the penalty was, in fact, an ordinary and necessary business expense. (*Keystone Metal Company* v. *Com.*, CA-3, 2/26/59.)

Depreciation and Salvage Value—Automobile Dealer

Decisions relative to depreciation of automobiles seem to be coming thick and fast. Last month we reported that the 9th Circuit Court of Appeals had held that the Commissioner's regulations, Sec. 1.167(a) (1) (b), were not to be applied retroactively with respect to measuring the useful life of automobiles used in the automobile *rental* business. In a recent case involving an automobile *dealer*, there is apparently a direct conflict in the Circuits based upon the rationale of the 5th Circuit, despite the difference in businesses. Noting that there has been no substantial change in the statute, the Court was "inclined to look with considerable disfavor on any contention that a slight change in the Regulations worked such a double shift in the effect of a simple statute allowing reasonable depreciation."

In this case, a dealer computed a negligible salvage value as at the end of three years, on cars used by its executives and employees on company business. It therefore deducted depreciation on the full cost based on a three-year life. However, the automobiles in question were sold, generally, in the first year after having travelled 8,000 to 10,000 miles. The excess of the sales price over the adjusted basis was reported as capital gain. The Court held that useful life was to be measured by the length of time it was used by the taxpayer in its business, and the salvage value to be deducted should be that which was reasonably expected to be realized upon sale after use for 8,000 to 10,000 miles. This of course, could result in no allowable depreciation at all.

A car in this case, purchased for $2,086, on which $348 depreciation was claimed (½ year on a three-year straight-line method) was sold 6½ months later for $2,695, and the profit reported as long-term capital gain. Accordingly, in addition to the use of the cars, the taxpayer was in pocket almost $600 after taxes.

Thus, in the instant case, the current regulations were held to be retroactive to the years 1951, 1952 and 1953 because they are "realistic" and because (to paraphrase the Court's opinion) it must have been Congress' intent. It should, however, be noted that the

instant case involved an automobile *dealer*, and the Court said that "it is quite doubtful that Congress ever intended that automobiles temporarily used by people in the business of selling automobiles should be subject to depreciation at all." (*U. S.* v. *Massey Motors, Inc.*, CA-5. 2/26/59.)

Automobile Expense

One of the recent developments in the "business expense" deduction field is the denial by the Tax Court of the automobile expenses of a corporation officer. The taxpayer had never claimed reimbursement for his automobile expenses since, as an official in charge of setting up for himself and his subordinates reasonable standards for expense accounts, he wished to eliminate automobile expense because he considered it an area of potential abuse. Although he alleged that he "promulgated a rule" that such expenses would not be reimbursed, the Court found provisions in the corporate minutes providing for reimbursement at set allowances per mile. It held, therefore, that the taxpayer could have been reimbursed and therefore the expenditure was not necessary to his employment (See Rev. Rul. 57-502, 1957-2 CB 118), and that his decision not to claim reimbursement could not change expenses of the corporation to those of the taxpayer. As expenses not incurred by the taxpayer, they are not proper deductions by him. (*Marvin A. Heidt*, T. C. Memo Op. 1959-31.)

The same doctrine was followed in *Earl M. Coplon* (TC Memo Op. 1959-34) where a sales manager was denied deductions for entertaining subordinates for which he could have been reimbursed upon request.

Commentary

Floor on Dividends Received Deduction is 72¼ Percent

In computing the corporation income tax, there is allowed a deduction of 85 percent of dividends received from domestic corporations. The Code, however, limits this deduction to 85 percent of taxable income computed without regard to the dividends received deduction. This limitation does not apply for any taxable year for which the corporation has a net operating loss.

There has been some misunderstanding of the limitation which comes into play in relatively few cases. Even where the limitation is applicable, the dividends received deduction will never be smaller than 72¼ percent of the dividends received. As previosuly noted, the provision restricting the deduction to 85 percent of taxable income is inapplicable for a taxable year for which the corporation has a net operating loss. The term "net operating loss" is defined in Section 172 of the Code. In determining whether or not a corporation has a net operating loss, the deduction for 85 percent of dividends received is allowed.

In order to determine whether the deduction for dividends received will be less than 85 percent, it is first necessary to determine if the corporation had a net operating loss. Thus, let us assume the following conditions:

Domestic dividends received..	$100,000
Excess of deductions over income (other than dividends)	60,000
Taxable income before deduction for dividends received	$ 40,000

The determination of the net operating loss follows:

Taxable income before dividends received deduction (above)	$ 40,000
Less dividends received deduction (85% of dividends received)	85,000
Net operating loss	$ 45,000

The limitation, therefore, does not apply. The corporation is entitled to deduct the full $85,000 dividends received deduction. The corporation's income tax return will reflect a net operating loss of $45,000. This net operating loss will be subject to the ordinary rules governing carrybacks and carryforwards.

Let us now verify the validity of the previous statement that in no case would the dividends received deduction be less than 72¼ percent of the dividends received. The only time the limitation would be applicable is where the corporation for the taxable year sustained an operating loss (exclusive of dividends received) which is less than 15 percent of the dividends received. Let us assume the following:

Domestic dividends received	$100,000
Operating loss (excluding dividends)	10,000
Taxable income before dividends received deduction	$ 90,000

There is no net operating loss in this particular case. Subtracting the $85,000 dividends received deduction from the $90,000 income would produce a $5,000 balance of income, not a loss. Therefore, in this particular case, the limitation is applicable. The dividends received deduction would, therefore, be equal to 85 percent of the $90,000 taxable income before the dividends received deduction. In this instance, the amount of the deduction would, therefore, equal $76,500, or 76½ percent of the actual dividends received.

The maximum loss of the dividends received deduction would occur in the following situation:

Domestic dividends received	$100,000
Operating loss (excluding dividends received)	15,000
Taxable income before dividends received deduction	$ 85,000

Since there is no net operating loss (85 percent of dividends received, or $85,000, when subtracted from the taxable income would not produce a loss), the limitation would be applicable. The dividends received deduction would, therefore, be limited to 85 percent of the $85,000 taxable income (exclusive of deduction), or $72,250. It should be noted that this illustrates the greatest restriction on the dividends received deduction. Instead of receiving a deduction of 85 percent, the corporation would wind up with a deduction of 72¼ percent of dividends received. In this particular case, the corporation's income subject to tax would be $12,750 ($85,000 less $72,250).

The fact that the dividends received deduction will never go below $72\frac{1}{4}$ percent of dividends received can be appreciated if we make one final calculation. Let us assume the following facts:

Domestic dividends received..	$100,000
Operating loss (exclusive of dividends)	15,001
Taxable income before deduction	$ 84,999

Applying the provisions of Section 172, we would wind up with a net operating loss of $1 after deducting 85 percent of the dividends received. Since we have a net operating loss, the limitation would not apply and the full $85,000 dividends received deduction would be allowed.

It should be noted from the last two examples that the difference of one dollar additional loss results in a difference of $12,751 of taxable income, or $3,825 in the corporation's income tax liability.

Use of Subchapter S for Incorporated Talent

Subchapter S furnishes entertainers and others who perform services under contractual arrangements with an opportunity to incorporate. Gross income from such services are clearly personal holding company income under current and prior Code provisions. Consequently, incorporation of personal talent, prior to the enactment of the 1958 Revenue Act, created many tax problems. However, gross receipts from personal services are not included in the type listed in Section 1372 (e) (5) which would result in an automatic termination of an election of a corporation not to be taxed.

The use of an election would open the gate to many advantages not heretofore enjoyed. High earning ability of such taxpayers is notoriously short-lived. Pension and profit-sharing arrangements are now available, as well as other fringe benefits such as major medical policies. The use of a corporation would not create any further problems (other than those that now exist) with respect to deductions for clothing and promotional expenses, inasmuch as any disallowance of deductions would affect the taxpayers at their own level, rather than on both the corporate and individual level.

In setting up a Subchapter S corporation, consideration must, of course, be given to the fact that most states do not recognize Subchapter S. Because of this, the stockholder would be subjected to double state tax on the earnings; one at the corporate level and one at the stockholder level.

Sale and Leaseback Transactions

Assume that Company *A* has a large amount of equipment which is more or less fully depreciated but still useful. The company would like to sell this equipment to outsiders, realize the capital gain and then lease it back at fair rental value. Since the taxpayer would realize a substantial gain on the sale, it wants absolute assurance that the gain would be taxed as capital gain and that the rental deduction would be allowed assuming both the sale price and the rental are fair.

A sale to an unrelated party followed by a leaseback for the entire life of the equipment, with the lessee given the right to remove the equipment at the end of its useful life and sell it for scrap, probably constitutes a financing rather than a sale. This would result in the non-recognition of any gain on the "sale" but on the other hand rental deductions would not be available, although some part of the "rentals" would be deductible as interest.

On the other hand, if the lease is for less than the remaining life of the equip-

ment and if the lessor has the right to remove the equipment and lease it to others at the expiration of the lease, a sale and rental arrangement would be considered to have taken place and will be treated as such for tax purposes. In such cases as *Standard Envelope Manufacturing Company* (15 TC 41, 1950) and *Mays Department Stores Company* (16 TC 547, 1951), the Government was unsuccessful in attempting to disregard sales of real estate followed by a leaseback. However, there is a distinction between a lease of real estate and a lease of equipment. With real estate the land will never disappear and it will always revert back to the owner at termination of the lease, while in the equipment situation, if the lease is for the entire life of the equipment, there is a sound basis for holding that the owner never parted with the ownership of the equipment and that the "selling price" is nothing more than the proceeds of a loan.

Problem Posed in Obtaining Stepped-up Basis of Assets of Acquired Corporation

The enactment of Section 334(b)(2) of the 1954 Code has generally established the rule of thumb that the acquisition in a taxable transaction of at least 80 percent of the stock of the corporation followed by its liquidation would provide a corporate purchaser with an aggregate tax basis of the assets received equal to a price paid for the stock. Thus, generally it is considered that a stepped-up basis will be available if the required percentage of stock is obtained and the liquidation is timely made. There is an exception, however, which has not received much publicity and which serves to limit the benefits of this section. The Code requires that the 80-percent rule be satisfied by an acquisition during a period of not more than twelve months. Where a corporate shareholder owns 21 percent or more of the stock of another corporation for more than twelve months, it would be unable to avail itself of a a stepped-up basis by the acquisition of additional shares to equal at least 80 percent of the total outstanding stock.

While this is a harsh rule, it is consistent with the historical development of the court decisions which led to the enactment of this provision. Those decisions permitted the purchaser to use its higher acquisition cost as its tax basis for the property received in liquidation of the corporation it recently acquired, on the theory that its intention was to purchase the assets and not the stock. The intention requirement was not incorporated into the statutory language and in its place are the various tests which must be met to obtain the benefits of the section. Where the liquidation would result in a stepped-down basis, it is often easy to avoid the effect of this new provision by deferring the liquidation. On the other hand, it is not easy to become entitled to the benefits of the section in the case of minority holders, as indicated above.

The solution may be possible in the case described above if the minority stockholder is willing to pay a capital gains tax on the appreciation of the stock it has held for over twelve months. This might be done by liquidating the acquired corporation. The minority stockholder would then acquire the assets of the corporation from the other shareholders instead of acquiring their stock. In this way, the minority stockholder would receive a stepped-up basis on the new acquisition and a stepped-up basis on the assets received for its old shares. Inasmuch as this procedure might raise practical difficulties and is not attractive because of the capital

gains tax, it is not a complete solution to the dilemma of the minority corporate stockholder which now wishes to acquire the assets of a corporation and obtain a stepped-up basis.

Disposition of Installment Obligations

Section 453 permits a taxpayer to report gain from sales of property on the installment basis, provided certain conditions are met. Should the obligations received under installment sales be transmitted, distributed, sold or otherwise disposed of, taxable gain or loss results in the year of disposition. In dealing with transfers of installment obligations between related taxpayers, Section 453 and regulations issued thereunder have provided several exceptions to this general rule.

The following transfers of installment obligations will generally be deemed to be non-taxable to the transferor:

Transferee	Transaction	Related section
Controlled corporation	Tax-free incorporation	351
Parent corporation	Liquidation of subsidiary	332
Surviving corporation	Merger or Consolidation	381
Partnership	Contribution by a partner	721
Outgoing partner	Withdrawal from partnership	731
All partners	Dissolution of partnership	731
Estate	Upon death of taxpayer	691

The following transfers of installment obligations will be deemed taxable to transferor:

Transferee	Transaction	Relate sectio
Donee	Gift	1001
Stockholder	Upon liquidation of corporation	331

Where a corporation adopts a pla of liquidation under Section 337 an sells its assets, under an installmen sale, within one year after adoptin the plan, there is no gain to the co poration upon distribution of its in stallment obligations to the stockholder This is so providing the installment ob ligations were received from sales quali fying for non-recognition under Sec tion 337. The transferee stockholders however, must take into consideratio the fair market value of the installmen obligations in computing the total re ceived on liquidation. Gain or loss o liquidation of a corporation is the measured by the total value of asset received less the basis of the stock o the liquidated corporation.

On the other hand, where stock holders elect to liquidate a corporatio within one month under Section 333 the gain to the stockholders is expressl limited by the provisions of that sectio But there is no mention of limiting th gain to the transferor corporation. I would appear that if a corporation hel installment obligations at the time o its liquidation under Section 333, th deferred gain would become taxable t the liquidating corporation upon dis tribution of such obligations to it stockholders, with a resultant increas in earned surplus, which in turn woul increase the taxable income to th stockholders.

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